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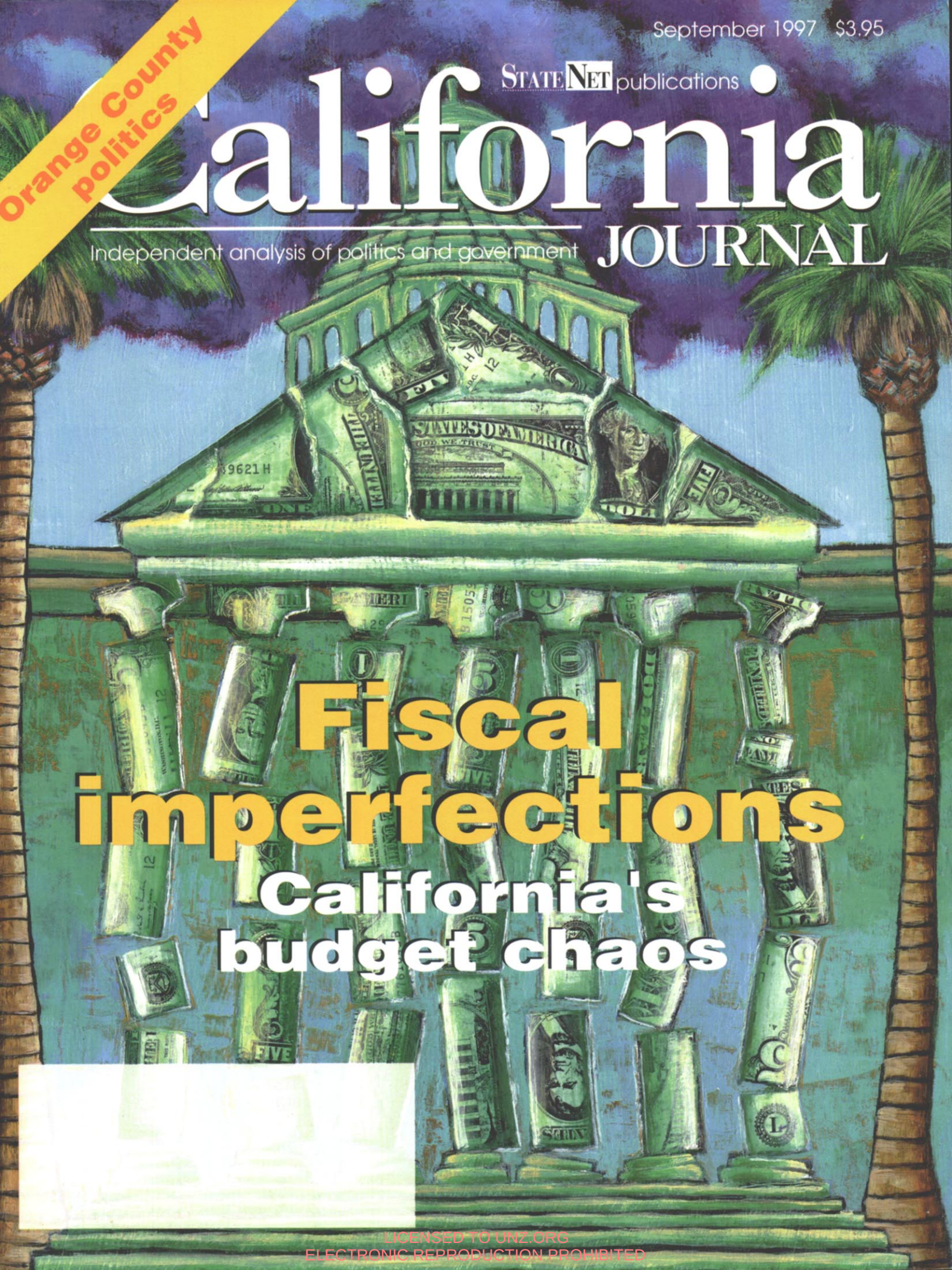

Fiscal imperfections

California's budget chaos

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SEPTEMBER 1997
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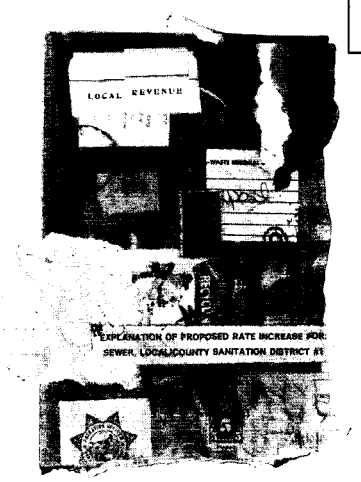

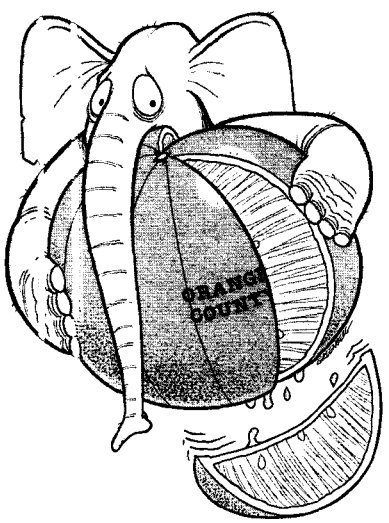

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Illustration by Santiago Uceda

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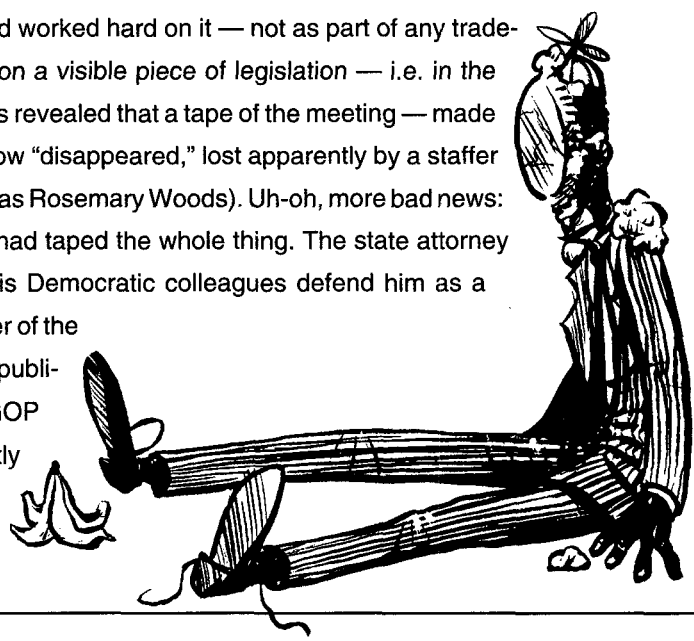
Upfront
umbrage

Evil empire. Bilingual education may have been a back-burner political issue recently, but it still has the capacity to get people at each other's throats. Witness the little spat between state Superintendent of Public Instruction Delaine Eastin and a Southern California local official. At a recent meeting, Westminister School Board president Michael Verrengia derided the state's bilingual education staff as a "merry bunch of communists." Eastin responded with a letter suggesting the comment was "highly unprofessional." Verrengia allows he made a poor choice of words, but hasn't apologized for the remark. But if the bilingual staff is a "merry bunch of communists," as he suggests, they would be very unique. Most of your hard-core commies tend to be dour, somewhat angry individuals, especially if they actually have to live under communism. Verrengia's comment makes them sound like some kind of comedy troupe — the Not Ready For Capitalism Players.

Potent quotables. Since Assemblyman Steve Baldwin (R-La Mesa) arrived in Sacramento in 1994, he's been trying to live down the perception that he's a right-wing zealot who sees official witches lurking in the bowels of the Pentagon. He's had some success in establishing himself on education issues, but it seems as soon as you put a hometown media microphone in front of the guy, strange things happen. Speaking on a San Diego talk show, Baldwin accused Assembly Majority Leader Antonio Villaraigosa (D-Los Angeles) of advocating "the physical overthrow of California." It gets better. "He doesn't even believe in the Boy Scouts, that they should exist," brayed Baldwin. "He doesn't believe there should be any felonies at all." Wait, it gets even better. "He's associated with the Brown Berets. He's been associated with Fidel Castro. Trained Communist guerillas, who have been at rallies along side him." For the record, a spokesman for Villaraigosa says the majority leader has never associated with Fidel Castro, trained communist guerillas, or been associated with the Brown Berets. He believes in felonies, likes the Boy Scouts and is "just fine" with the idea of California being in the United States. The best Baldwin's office could come up with to verify his claims was a conspiracy-theory website called VCT — Voices of Citizens Together. The

Rookie mistakes.

There's an old saying: "No good deed goes unpunished." Want proof? Just ask freshman Assemblyman Carl Washington (D-Paramount). Washington was sitting as a member of Assembly Labor Committee when his colleague, Assemblyman Ed Vincent (D-Inglewood) brought in a controversial, pro-tobacco bill. Explaining his "yes" vote, Washington said that he didn't approve of smoking, but as Vincent had supported "a bill important to my district," then he would give him a "courtesy vote" on the pro-smoking measure. Can you say "quid pro quo?" How about "felony"? Washington was immediately hustled aside by frantic colleagues, after which he made it clear he was supporting Vincent's bill because he'd worked hard on it — not as part of any trade-off. Too late. Washington had committed his gaffe on a visible piece of legislation — i.e. in the presence of reporters. The plot thickened when it was revealed that a tape of the meeting — made at the request of the committee chair — had somehow "disappeared," lost apparently by a staffer (there's no truth to the rumor that the staffer's name was Rosemary Woods). Uh-oh, more bad news: one of the reporters worked for a radio station and had taped the whole thing. The state attorney general's office is investigating the incident, and his Democratic colleagues defend him as a decent, if naive, guy. Now you'd think when a member of the opposition all but admits to a felony in public, the Republican P.R. machine would kick into overdrive. But the GOP is strangely quiet on the gaffe. Could be they tacitly understand what Washington's Democratic colleagues imply in their defense: That this sort of mutual back-scratching goes on all the time in the Legislature.



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web site features reports, photographs, and sundry other harangues, all purporting to document the impending takeover of the United States by that military powerhouse, Mexico. For these people, opposition to Proposition 187 is tantamount to a confession of complicity in the Mexican takeover plot. Hmmm. Could be on to something there, Steve. Tell you what — why don't we just move the Capitol to Area 51? We could elect Oliver Stone as governor and make G. Gordon Liddy the chief justice of the state Supreme Court.

Leaderspeak. Maybe Assembly Speaker Cruz Bustamante (D-Fresno) is getting the hang of this leadership thing after all. He certainly seems to have mastered the art of diplomatic obfuscation. During leadership negotiations on the state budget, Bustamante kept showing up with handfuls of new pork-barrel member requests. When asked what he was doing, Bustamante insisted the items were not "pork barrel" projects. They were "district enhancements." Uh-huh. And tax increases are "revenue enhancements" and hair plugs are "scalp enhancements." Not to be outdone, Bustamante's opposite number in the state Senate, pro Tempore Bill Lockyer (D-Hayward) had his own unique turn of phrase as the budget talks wound down. Referring to Governor Pete Wilson's decision to drop a "neutron bomb" on the talks by paying off a massive court settlement all at once, Lockyer said Wilson had left them with little to talk about. "There are no cookies in the cookie jar after the neutron bomb," said Lockyer. Sounds like they've developed a new miniature version of the neutron bomb — it kills the cookies, but leaves the jar standing.

Hello, Larry. A few days before last week's floor votes on the compromise welfare reform package, some constituents of Assemblyman Larry Bowler (R-Elk Grove) received a bit of unsolicited mail from their assemblyman. The four-page mailer was delivered under the official Assembly postmark, a sign that it was taxpayer financed. The mailer excoriated the welfare state and touted the "Assembly Republican Welfare Reform Plan." It also included a return card if the constituents wanted more information on welfare reform. So what's the big deal? For one thing, the "Assembly Republican Welfare Reform Plan" was actually Governor Pete Wilson's plan. Moreover, the partisanship of the mailer made it look more like an election-year hit piece than "constituent correspondence." And the screwiest part is that it showed up in the mailbox more than a week after Assembly Republicans had signed off on a compromise, which rolled back some of the provisions Bowler was now touting. In other words, the mailer had long since been rendered irrelevant. Sounds like there may be a little padding in Larry's office budget. Or maybe Larry just needs to pick up a newspaper now and then.

Tales from the coup. Leave it to that irrepressible surfin' man, Representative Dana Rohrabacher (R-Newport Beach) to try to find a way to break the internecine tensions among House Republicans during their recent leadership fight. As GOP members emerged from a fence-patching caucus meeting, Rohrabacher launched into an impromptu tune. "Heigh Ho, Heigh Ho, it's back to work we go," warbled the conservative lawmaker, hoping to spark a happy little sing-along. Alas, after a session in which the duplicity of some of their leadership was revealed, nobody seemed much in a singing mood. So Rohrabacher was way out there by himself. In other words, situation normal. Getting a better response from colleagues was another California Republican, Representative David Dreier (R-Covina). Dreier's stock has climbed precipitously in the wake of the failed run at the leadership of House Speaker Newt Gingrich. While none of the Gingrich lieutenants who were involved with the coup attempt were formally ousted, Dreier — a Gingrich loyalist — has become the tacit leader of what *National Journal* calls "Newt's Kitchen Cabinet." The 45-year-old Dreier, who sits on the powerful Rules Committee, has good relations with newcomers and established members alike. As his stock in the House continues to climb, his decision not to risk it with a U.S. Senate run against Barbara Boxer looks better and better.

"A little vagueness goes a long way in this business."
— Edmund G. "Pat" Brown

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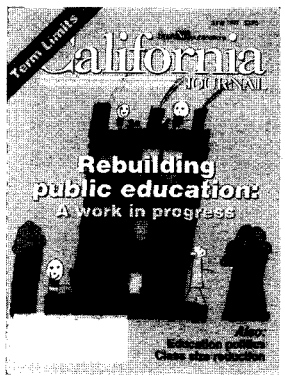

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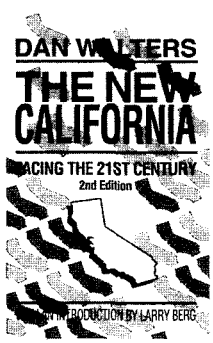

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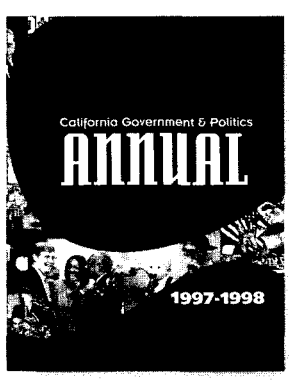

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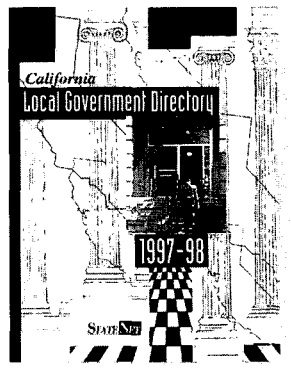

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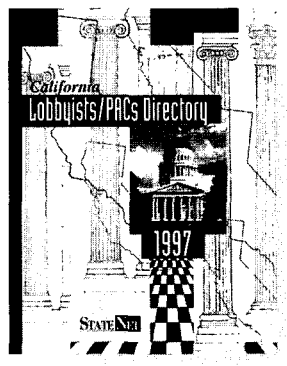

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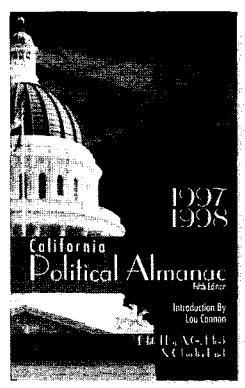

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Two Cents commentary

Farewell

This issue marks the first time in 27 years that my name has not appeared at the top of *California Journal's* masthead. After more than a quarter of a century, it's about time.

The reason for the change is a unique opportunity to continue my interest in public service in another venue. Beginning in August, I assumed a new post as national executive director of Coro, the widely respected public affairs training program founded in San Francisco in 1941 with centers now also in New York, St. Louis, Kansas City and Los Angeles. Coro has trained more than 4000 people, most of whom are contributing to society in the public affairs arena — in the corporate world, as labor leaders, in state and local government, in the media or as elected officials (U.S. Senator Dianne Feinstein and Representatives Vic Fazio and Jerry Lewis, to name but three). My job is to strengthen Coro, to expand it and to make it as well known nationally as it is in California, challenges that my *Journal* experience will help me meet. This job will be more than full time, but I will remain available to the *Journal* for consultation.

I could not leave without sharing some thoughts about the *Journal* itself and the world it serves. One of the ways we have managed to be successful in the magazine business has been our openness to change. Change is good. Who would want to read a 1970-style *Journal*, with its lack of graphics (or ads, for that matter) and bylines (the *Journal* was speaking, not a mortal reporter) and with a writing style as lively as that of government commission reports?

Today's *California Journal* is the best it's ever been in many ways. Our readers are better educated, more involved and more influential than ever. Advertising sales are strong and actually contribute to the appearance and interest of the magazine. The *Journal* is financially solid — not highly profitable, perhaps, but secure, backed by the resources of State Net, the nation's leading legislative tracking service. The staff is larger than ever and more talented (high praise considering how many first-class journalists have worked here over the years). Every month this crew comes up with fresh ideas on how to bring the essence of California's complex and ever-changing issues to you, our readers.

These all are changes from the early years.

Yet many things have remained the same. From day one we have made the reader our primary focus. We have attempted to write each article and assemble each issue with the question, "What does the concerned citizen need to know about what is going on?" In this vein, we have attempted to provide citizens with the tools they need to participate effectively in their self-government. Hence the annual rosters and the extensive analyses of every Assembly and Senate race. We also have stayed constantly nonpartisan, equally skewering and occasionally praising Republicans and Democrats, liberals and conservatives as the occasion demanded. Our circulation exactly reflects the state's voter registration.

After 27 years of making suggestions to my reporter colleagues, I can't resist the temptation to do it one more time. So, here are some thoughts on how to begin the next 27 years.

First, don't take yourselves too seriously. State government and the issues it is addressing are important and growing more so, but they are not the whole world. Look for the humor and the offbeat. Without eliminating the emphasis on politics, take time to look at the geography, history, art and literature, social life and non-governmental aspects of California.

Don't be embarrassed to shed your reporter's cynicism. Sometimes good things happen in the Legislature and elsewhere, and it is no sin to say so.

Consider advocacy. We have prided ourselves on our independence for the last 27 years and have not endorsed issues or candidates. But during this time, citizens by the millions have turned off to the political process. Voter participation has steadily declined. People have lost faith in the political process and in government institutions. If not broken, the system is badly bent. The *Journal* could become a forum for discussion of proposals to straighten out the politics and institutions of government (including campaign finance, the initiative, dirty campaigning, voter access, role of the press, term limits, reapportionment, the two-thirds budget vote and state-local relations). The *Journal* could advocate reform in general without necessarily becoming an advocate for a specific plan (although I personally think last year's Constitutional Revision Commission plan was an example of a proposal that deserved more consideration than it got from our political leaders).

Keep changing and evolving: It's the best way to keep yourself fresh and the reader engaged.

I am leaving *California Journal* because it is high time I practice in my personal life what I preach for the *Journal*. I look forward to my Coro future, but I will miss *California Journal* and especially the subscribers who were always engaged in "their" magazine. I wish you well.

Farewell, *California Journal*.

— *Tom Hoeber*

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Fiscally Unfit

The process of drafting a state budget has become an annual exercise in creative financing and partisan brinksmanship. Are California policymakers to blame for the state's budget dysfunction, or is failure built into the system?

by Steve Scott

In the time of ancient Rome, Julius Caesar was warned to "beware the Ides of March." At least, that's what William Shakespeare would have us believe. For those whose business is the budget of the state of California, however, the day of reckoning usually comes around the Ides of May. The fifteenth day of the fifth month is about the time when the mystics in the state Department of Finance peer into their crystals and deliver to the governor and the Legislature their fiscal future.

For most of the 1990s, the Ides of May has been a bitter time. The plagues of economic recession, natural disaster and demographic transformation conspired to push California's government into monstrous, cavernous deficits — at times, deficits that were larger than the entire budgets of most states. Mid-May is also the official starting point for the customary war of nerves between Governor Pete Wilson and the state Legislature — a war that mostly pits Wilson against Democrats but occasionally lines him up against fellow Republicans.

In 1997, it looked as thought the situation would be different. The mood around mid-May was almost giddy with excitement. The economic recovery had pumped more than $2 billion in unexpected dollars into the state's coffers. Moreover, dwindling caseloads in the state's social programs — an outgrowth of the new

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prosperity — meant even more money would be available to spend. The total windfall: more than $3 billion. Surely this bounty would allow the Legislature and the governor to exorcise once and for all the ghosts of 1992 and of other painful budgets past.

> **This process is really, really hard on the people involved.**
>
> **— Craig Brown**
> **State Finance Director**

No such luck.

Rather than breezing through June tossing out money left and right, the Legislature and the governor found themselves right back in the same cycle of brinksmanship. Compared with past years, the two-house budget conference committee almost sleepwalked through May and June, going long stretches without meeting while members looked to their four caucus leaders and the governor for guidance. That leadership, embodied in what has come to be known as "the Big Five," didn't even start serious discussions until the last week of the 1996-97 fiscal year, and their first meeting was abruptly ended in a dispute over whether staffers would be allowed in the room.

Just when things seemed to be getting on track, one party or another would lob some new complication into the mix. First, it was Wilson who, two weeks into the new fiscal year, decided the time was right to drop a $1 billion income-tax cut into the mix. Assembly Democrats, led by rookie Speaker Cruz Bustamante (D-Fresno), responded with an initiative aimed at restoring food-stamp benefits to legal immigrants, whose aid had been cut off by the federal government. Then it was Wilson again. The governor abandoned his tax cut plan and dropped what he called "the neutron bomb," ordering the immediate payment of a $1.36 billion court settlement to the Public Employees Retirement System. The money had been diverted from PERS to help finance past deficits. The end result: The second longest budget stalemate in state history.

"This year has been a disgrace," said Wilson, in a late July interview with the *Los Angeles Times*.

Wilson subsequently moderated his tone somewhat, blaming many of this year's problems on circumstances. In addition to the court decision which occasioned the PERS payment, the Legislature also had to work through the state's response to the federal welfare reform law, a task that had some implications for the budget. Wilson's explanations were echoed by lawmakers on both sides. It wasn't their fault. The fates were lined up against them.

Perhaps. Or perhaps, as Shakespeare's Cassius observed, "Men at some time are masters of their fates," and that, for Wilson and the Legislature, the fault lay "not in our stars but in ourselves...." And again, perhaps there is a third explanation — one that combines both the hand of fate and the hands of men (and women). Maybe there is something about the way budgets are created in California that makes it almost impossible to pull them together, even in the good times. Maybe the process has become so contorted that nobody, no matter how talented or experienced, can navigate it without being bounced around.

Maybe it's just the system.

"This process is really, really hard on the people involved," said Craig Brown, Wilson's current Finance Director. "There is nothing but 'up' time for people in the budget business. They just never get a break."

Although California has had a Legislature since it became a state in 1850, it is only in the last 75 years or so that it has had what might be called a formal budget process. Fed up with what it considered an extraordinarily loose attitude toward its fiscal affairs, the San Francisco-based Commonwealth Club qualified an initiative which, in effect, created a state budget. The 1922 initiative included many of the basic concepts still used to draft budgets today, including the January introduction by the governor, the fiscal review process in the Legislature, and the May revision. It also was the first of what would eventually become a stream of ballot measures — many of them created outside the legislative process — which would add layer upon layer of restrictions on where and how policy makers could raise and spend tax money (see "Ballot Box Budgeting," page 12).

The next, and arguably most significant, event in the state's budget history came in 1933 with voter approval of the Riley-Stewart Act. Enacted as a way to protect education spending from the ravages of the Great Depression, the act included a number of refinements to the process outlined in the Commonwealth Club's measure. Among those refinements: a provision that any increase in non-education state spending that exceeded 5 percent must be approved by a two-thirds vote of both houses of the Legislature. In the 1960s, the 5 percent threshold was removed.

For many critics of the state budget process, the two-thirds vote requirement introduced in the Riley-Stewart Act is the "original sin." By all accounts, the two-thirds majority allows a relatively small, cohesive minority to strongly influence the process. "California is foolish to be the only state in the country that requires a two-thirds vote to adopt a budget," said Senate President pro Tempore Bill Lockyer (D-Hayward). Some critics of the requirement say it has become more intrusive in recent years as partisan tensions have escalated to new levels.

"When you have competitive politics, that tends to breed mistrust," said former Assemblyman Phil Isenberg (D-Sacramento), who was involved with the budget process both as a staffer and an assemblyman. "As the [numerical] partisan division has narrowed, the ability to pass a budget is made less likely because of the two-thirds vote requirement."

Defenders of the two-thirds vote say it is an essential check on the majority party in the Legislature. "The budget is a two-thirds vote vehicle but sometimes the majority party forgets that," said Assembly Minority Leader Curt Pringle (R-Garden Grove). "It's important to remind them that to get votes on both sides and get the governor to sign it, you have to take in some of [the minority's] input." Some involved with the budget process say there figures to be budget conflict any time the government is divided between the two political parties. New York State, for example, went more than four months past its budget deadline this year, despite a simple majority vote, because of a showdown between the Demo-

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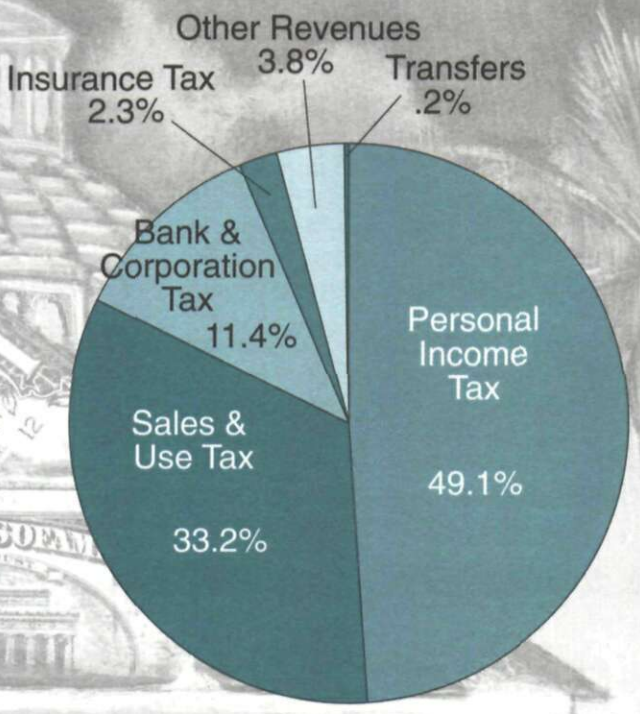
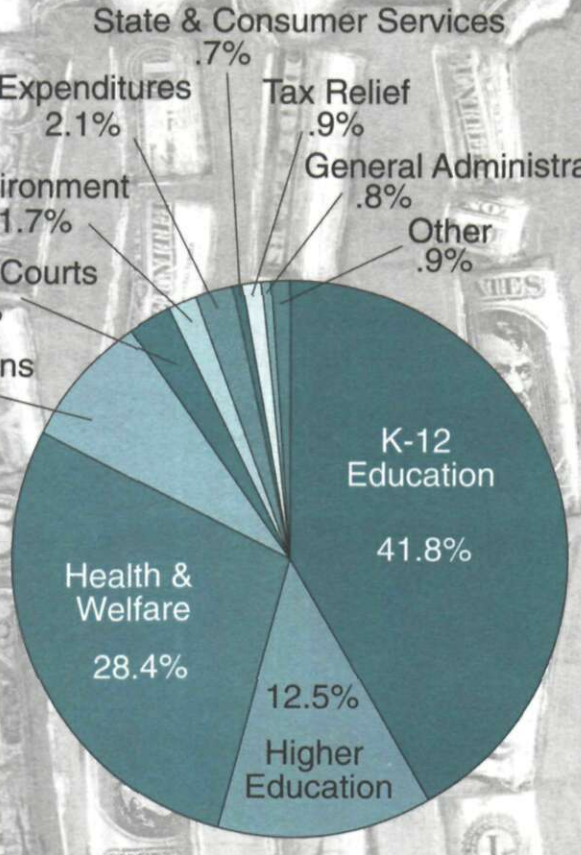
The 1997-98 State Budget*

General Fund Revenues
$52.6 billion



General Fund Expenditures
$52.6 billion



* Percentages based on budget as approved by Legislature, pending governor's signature

Source: Department of Finance

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crat-led Assembly and the Republican-led Senate, which was pushing the agenda of the Republican governor.

"If the governor and the two houses were all of the same party, the minority would be excluded if it wasn't for the two-thirds vote," said Brown. "As long as one party controls one of the three, I think it's more of an argument than a genuine barrier."

Rather than searching the mists of time, many who have argued for changing the budget process say the problems that have beset the process have been the product of more recent events. "None of these things, standing alone, could be changed and guarantee that a wonderful world would exist," said Isenberg. "Cumulatively, however, all these individual changes make it very difficult to be flexible and fast on your feet."

• *Ballot Box Budgeting.* While the roots of California's proclivity for budgeting by initiative date back to the 1920s, most trace the beginning of the modern era of "ballot-box budgeting" to 1978, and the passage of the landmark property-tax law, Proposition 13. While Proposition 13's specific provisions dealt with taxes levied locally, its wake resulted in an extraordinary concentration of power in the hands of state government. Proposition 13 was only the first of a string of budget-related ballot measures. The next year came Proposition 4, the Gann spending limit. A decade later there was Proposition 98, which set aside 40 percent of the budget for public education, and Proposition 99, which increased cigarette taxes but put the money aside for a variety of predetermined functions. Propositions 4 and 98 were then modified by Proposition 111, placed on the ballot by the Legislature. And on and on right through November of last year (see accompanying chart, "Ballot Box Budgeting," pages 12-14). Combined with the spending restrictions imposed by federal mandates and a host of smaller, self-imposed restrictions, the ballot limitations have restricted the ability of the governor and the Legislature to truly establish the state's priorities. "When you only have 10 percent of the budget that's discretionary ... you're just moving the chairs around," said Senator Ken Maddy (R-Fresno), a former Senate minority leader.

• *Tough times.* Throughout most of the 1990s, California was caught in the grips of what, by most accounts, was its

Ballot Box Budgeting: *Budget-related propositions*

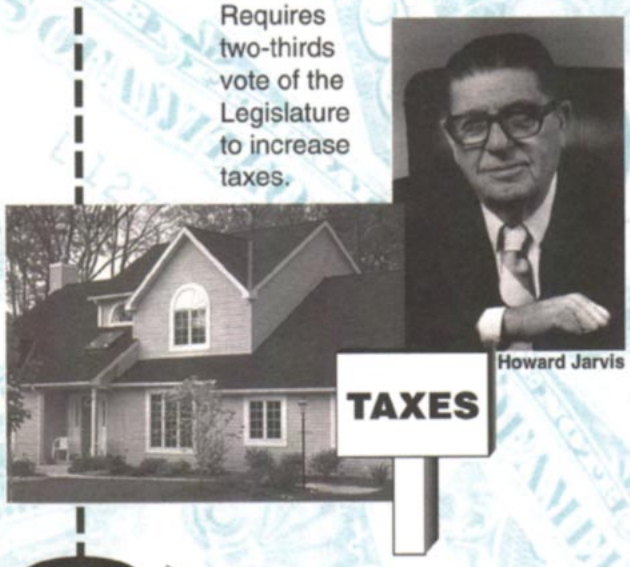
1879 ▶ **Constitutional Convention.** Initiates two-thirds vote requirement for passage of local school bonds.

1911 ▶ **Constitutional amendment** creating initiative process.

Hiram Johnson

1922 ▶ **Commonwealth Club Initiative.** Creates framework and general timeline for consideration and enactment of the state budget.

June 1978 ▶ **Proposition 13.** Landmark property tax initiative. Caps property-tax rates and limits hikes in assessed values. Gives state control of local property-tax revenues. Requires two-thirds vote of the Legislature to increase taxes.



Howard Jarvis

1933 ▶ **Riley-Stewart Amendment.** Establishes two-thirds vote requirement for passage of the state budget.

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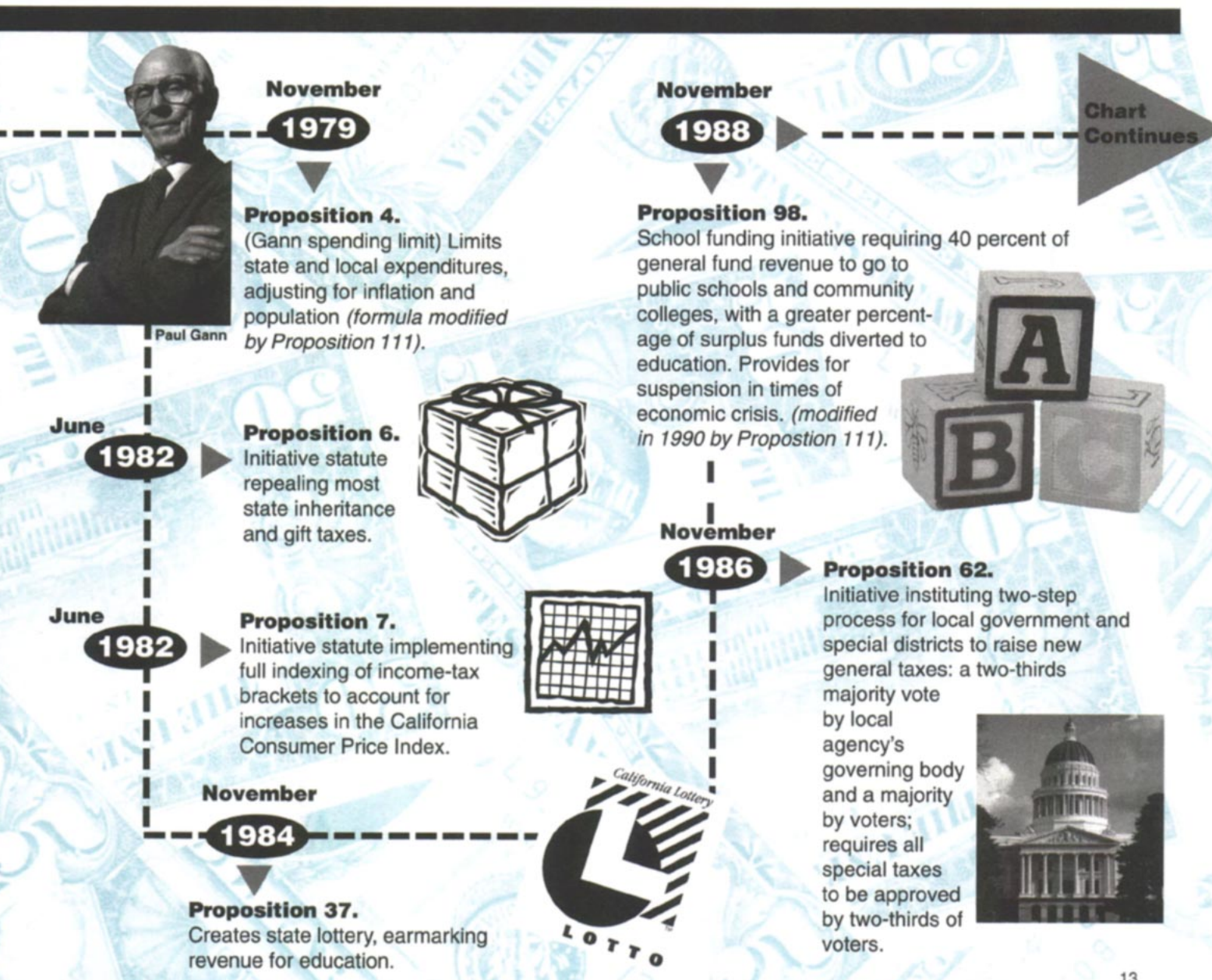
worst recession since the Great Depression. The budget which confronted Wilson his first year in office came with a $14 billion hole in it — staggering by all measures except those of the federal government. Then there were the disasters — drought followed by flood in the North, rioting followed by earthquakes in the South. Further compounding the challenges were the demographic shifts under way in the state, which has been losing residents to other states while gaining residents from other countries. Even this year, with its rosy economic news, was encumbered by an enormous policy hurdle — the implementation of the new federal welfare reform law. "The problems have become more complex because life in California has become more complex," said Bill Hauck, who chaired the recently sunsetted California Constitution Revision Commission, which looked at the budget process, among other things. "There are more people here and everything is interrelated."

• *Term limits.* Although it is not generally looked upon as a "fiscal" initiative, 1990's Proposition 140, which imposed six-year term limits on assembly members and eight-year-limits on senators, has had a significant impact on the budget process. Its term-limiting provisions pushed many of the Legislature's veteran budget wonks to move up or move out. The impact was especially heavy on the Assembly, which lost veteran budget wonks like Isenberg and longtime Ways and Means Committee chair (now Senator) John Vasconcellos (D-San Jose). There also was a substantial talent drain occasioned by the initiative's restrictions on the Legislature's budget, pushing many competent budget staffers to the private sector. That kind of talent drain has made it more difficult for the Legislature to exercise any kind of knowledgeable oversight. "Our budget looks like the Manhattan phone book," noted Assemblywoman Debra Bowen (D-Marina Del Rey). "To expect any legislator to be really familiar with that in a year or two, or even three or four, is just unrealistic."

• *Partisan friction.* Prior to the Watergate-era movement toward "open government," the two-house budget conference committee held its meetings in secret. "When I first came here [as a staffer in 1971], the budget conference committee was held in the Senate lounge," recalled Isenberg. "At the time, it was seven people — six conferees and


November
1979
Proposition 4.
(Gann spending limit) Limits state and local expenditures, adjusting for inflation and population *(formula modified by Proposition 111).*
Paul Gann
June
1982
Proposition 6.
Initiative statute repealing most state inheritance and gift taxes.
June
1982
Proposition 7.
Initiative statute implementing full indexing of income-tax brackets to account for increases in the California Consumer Price Index.
November
1984
Proposition 37.
Creates state lottery, earmarking revenue for education.
California Lottery
LOTTO
November
1988
Chart Continues
Proposition 98.
School funding initiative requiring 40 percent of general fund revenue to go to public schools and community colleges, with a greater percentage of surplus funds diverted to education. Provides for suspension in times of economic crisis. *(modified in 1990 by Propostion 111).*
A
B
November
1986
Proposition 62.
Initiative instituting two-step process for local government and special districts to raise new general taxes: a two-thirds majority vote by local agency's governing body and a majority by voters; requires all special taxes to be approved by two-thirds of voters.

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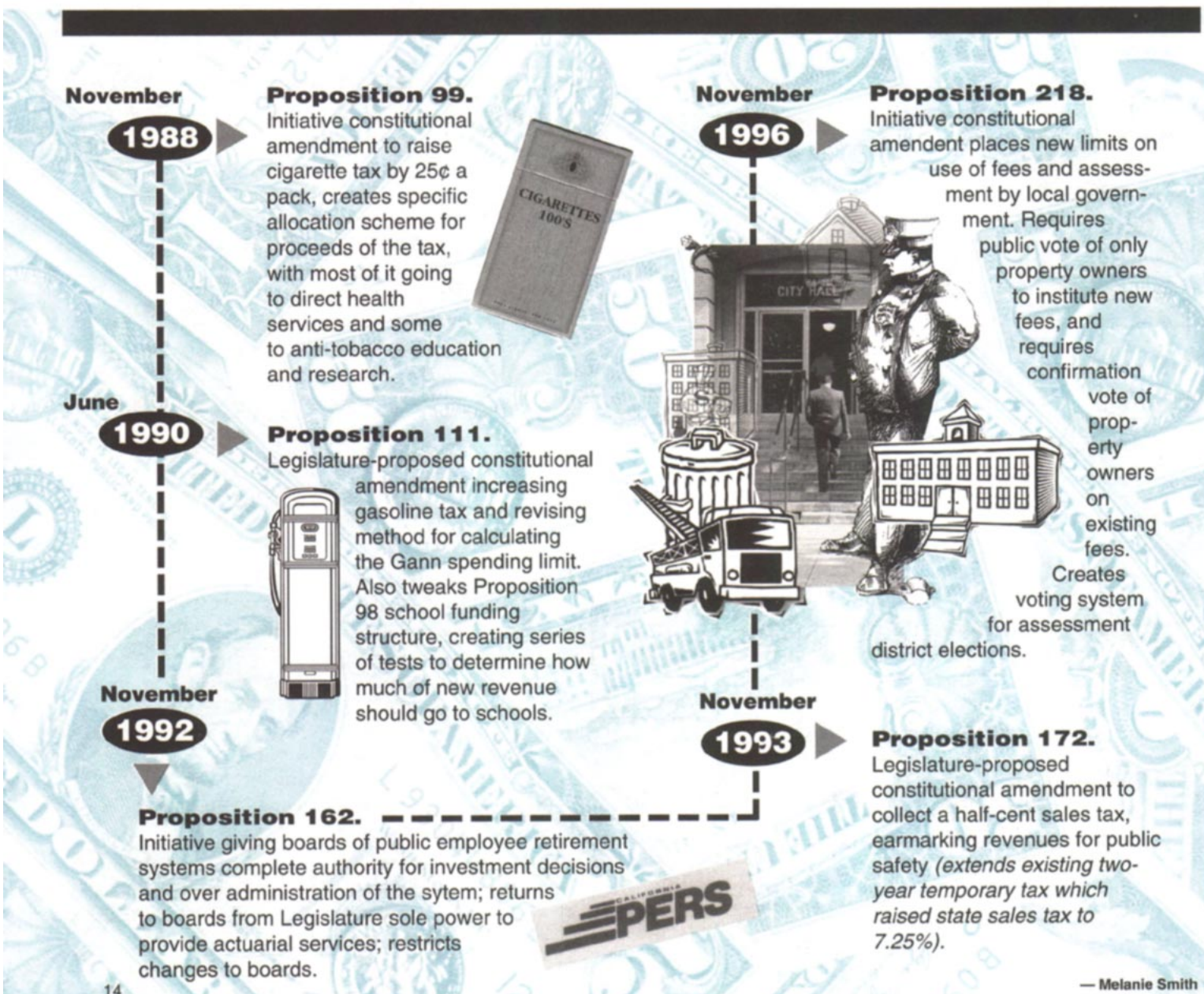
[Legislative Analyst] A. Alan Post." The increasing openness of the committee process, coupled with the narrowing partisan margins in both houses of the Legislature, have turned the budget process into an elaborate, almost ritualistic game of political one-upmanship. The clearest example was the agonizing record-setting 1992 standoff, which lasted 64 days. For roughly the first 30 of that, the two parties more or less talked past each other, staging meaningless floor debates and holding dueling news conferences in a bid for public support. The state was forced to issue IOUs, and California government set an unprecidented standard for gridlock.

Wilson's own intimate involvement in the process compounds the friction, as he often finds himself in direct — and sometimes personal — confrontation with his Democratic rivals. This year, between his tax cut and PERS payoff proposals, it almost seemed that Wilson went out of his way to throw roadblocks into the budget process. Forty-two days after the budget deadline, when lawmakers finally approved a spending plan, Wilson was still in the game, threatening to veto the whole thing in a dispute over whether standardized tests should be administered in English only. He subsequently backed away from the threat.

The most visible response to all the structural and political complications which have been layered on the budget process in recent years has been the rise of the "Big Five." Conceived in the early 1980s as a response to what was then considered to be an unimaginably huge $1 billion shortfall, the convention of convening closed-door meetings between the governor and the legislative leadership gained its first real foothold in the rolling deficits of the early 1990s. The rationale was that the deficits were so huge, and the policy issues so enormous, that only the leaders were capable of putting together a compromise that could win the necessary two-thirds vote of both houses.

Although the economic upheavals of the early part of the decade have subsided, the Big Five has remained a fixture in the state's budget picture and receives significantly greater media attention than any meeting of the Legislature's budget conference committee. In recent years, Big Five meetings have even had agendas, handouts and staff support. According to many of its participants, the scope of the


November
1988
Proposition 99.
Initiative constitutional amendment to raise cigarette tax by 25¢ a pack, creates specific allocation scheme for proceeds of the tax, with most of it going to direct health services and some to anti-tobacco education and research.
CIGARETTES
100'S
June
1990
Proposition 111.
Legislature-proposed constitutional amendment increasing gasoline tax and revising method for calculating the Gann spending limit. Also tweaks Proposition 98 school funding structure, creating series of tests to determine how much of new revenue should go to schools.
November
1992
Proposition 162.
Initiative giving boards of public employee retirement systems complete authority for investment decisions and over administration of the sytem; returns to boards from Legislature sole power to provide actuarial services; restricts changes to boards.
PERS
November
1996
Proposition 218.
Initiative constitutional amendent places new limits on use of fees and assessment by local government. Requires public vote of only property owners to institute new fees, and requires confirmation vote of property owners on existing fees. Creates voting system for assessment district elections.
CITY HALL
November
1993
Proposition 172.
Legislature-proposed constitutional amendment to collect a half-cent sales tax, earmarking revenues for public safety (extends existing two-year temporary tax which raised state sales tax to 7.25%).

— Melanie Smith

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meetings has extended well beyond the big issues, sometimes reaching down into departmental minutae. "When I was down there," recalled Maddy, a Big Five alumnus from his years as Senate minority leader, "my caucus members who were sitting on the conference committee would say, 'Well, what am I doing here if you guys are going to make all the decisions?'"

Defenders of the Big Five, mostly its participants, insist the meetings are nothing but a somewhat more formal version of the kind of interaction that has always taken place between legislatures and governors. "They used to have those meetings all the time," said Lockyer. "It's just that now, the governor tells the press." Pringle argues that the Big Five is a good safety valve to check against what he believes is the refusal of majority Democrats to take his caucus seriously. And Brown argues that, rather than a gubernatorial intrusion into the process, the Big Five actually works to protect the Legislature from being rolled over by the chief executive. "The constitution gives a strong governor a hell of a lot of power," said Brown.

Others outside the process, however, say this year's protracted budget fight suggests that the Big Five has outlived its usefulness. For one thing, critics argue, the very existence of the Big Five has given the conference committee an excuse to punt on an increasingly broad range of budget issues. Open government advocates claim the secrecy of the process prevents the public from having its voice heard. Others suggest the process may have become too public. So much attention was focused on the Big Five that it was forced to punt discussions on welfare reform to yet another ad-hoc working group of legislators, dubbed "the Little Four."

"It was essential during the first two budgets of the recession to have the leaders working all the time on it," said Fred Silva, a former legislative staffer who served as executive director of the Constitution Revision Commission. "What happened was that we drifted into this process of saying, 'Well, we'll just let the Big Five do it.'"

While some critics have suggested that the Big Five be abolished altogether, those closest to this year's budget suggest a better approach would be for the Legislature to reclaim its share of the budget process. In many cases, that simply means getting an earlier start on things. One problem is that the Legislature's budget mechanisms don't really crank up until the May budget revision. In an effort to get things started earlier, the administration agreed to resist the temptation to tinker too much with programs that weren't affected by caseload growth or education funding. It didn't work out, said Brown, because lawmakers were still too focused on the May revision.

"They could have exercised better discipline and gotten things wrapped up quicker that were not going to be touched in the May revision," said Brown.

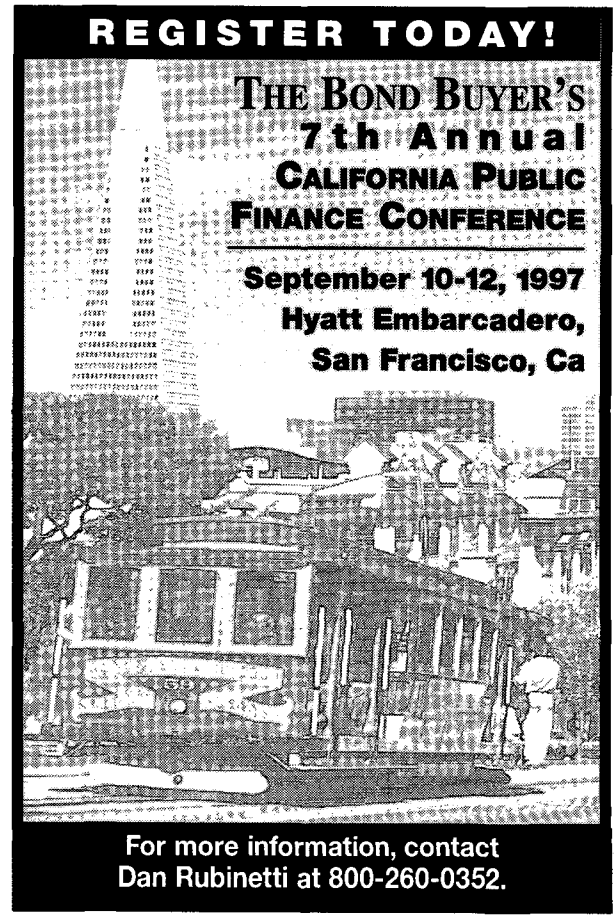
Brown concedes, however, that in-house procedural reforms are only part of the answer to California's budget dilemma. Perhaps more than any single event, it was the budget deadlock of 1992 that prodded lawmakers and Governor Wilson to agree to set up a Constitution Revision Commission to explore ways to make sense of the state's fiscal system. The commission's formal report to the Legislature and the governor included a package of state budget reforms. The commission called for budgets to be drafted for two years instead of one, with the two-year plan to be "rebalanced" after the first year. The commission also called for restrictions on the state's debt load, sanctions on legislators for missing deadlines, and a simple majority for passing the budget. The complicated politics of the era prevented the commission's proposals from gaining much of a foothold in the Legislature or with Governor Wilson. Brown, however, believes they are worth a try, particularly the idea of a two-year budget.

"This budget process is almost non-stop," said Brown.

Efforts to follow up on the work of the commission are still in the formative stages, and those involved hope the initial resistance to change can be overcome. Hauck says it is unlikely lawmakers themselves will undertake to radically change the status quo. "Before there's going to be substantial change, a constituency has to be developed outside of Sacramento," he said.

Even those involved with the commission concede, however, that no process reforms are going to rid the system of gridlock. No amount of procedural tinkering, for example, could have prevented Wilson from dropping a brand new tax cut plan on the Legislature two weeks after the constitutional budget deadline. Nor can any process reforms prevent the formal or informal linkage of the budget to such political hot potatoes as welfare reform or English-only testing. Ultimately, the success or failure of the budget process depends in large measure on the goodwill — and hard work — of its participants.

"The American system is to have balancing powers," said Isenberg. "Americans want that but then they bitterly complain when the system is inefficient. Well, it was intended to be inefficient."



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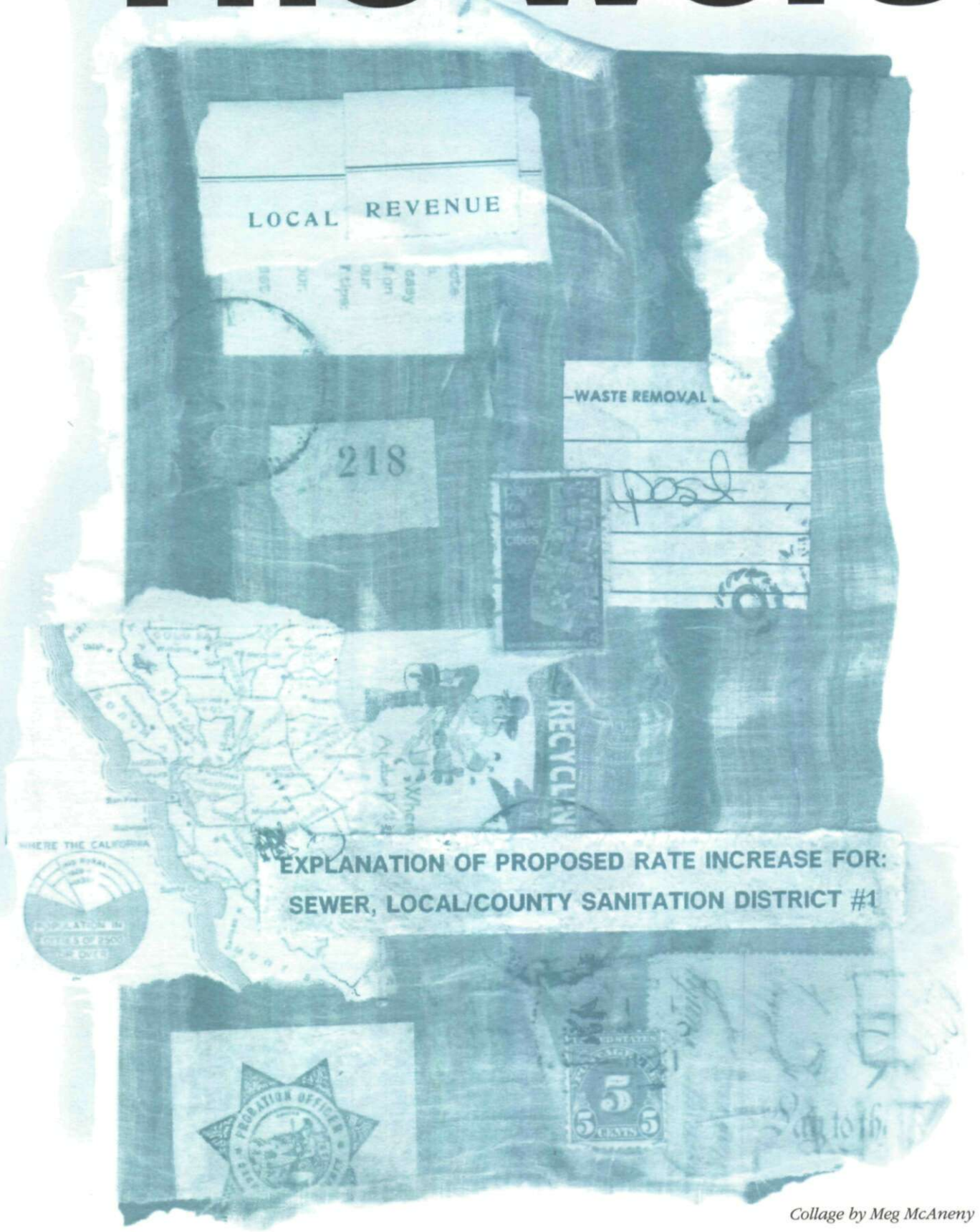
The Worst



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# of Times

Local governments got creative in the wake of Proposition 13 to keep services flowing. But many officials say the Legislature — and state voters — have combined forces to put them at the brink of insolvency

by Noel Brinkerhoff

Ask almost any member of a city council or county board of supervisors about the system of finance under which local governments must operate and the answer is likely to revolve around a single notion: dysfunctional. Increasingly, local officials find themselves in situations where the needs of their communities — be they road repairs, public safety, welfare assistance, or whatever — continue to expand and demand more funding, while the revenue sources that pay for these services either are plundered or become handcuffed by political decisions made beyond the local level. If it's not billions of dollars in property taxes being shifted each year from local government to help Sacramento balance the state budget, local officials complain, it's yet another ballot initiative making it tougher for local officials to raise the money needed for both local and state-mandated programs.

In recent years, the debate has tended to focus on last November's Proposition 218 or the property tax shift that began earlier this decade. In fact, the discussion really started in June 1978. At that time, an overwhelming number of voters decided — with the passage of Proposition 13 — that it was time to rollback skyrocketing property tax rates that were burdening millions of homeowners. The immediate consequence of this decision was the loss of $7 billion in revenue for local government programs, by capping the property tax rate at 1 percent of a property's assessed value.

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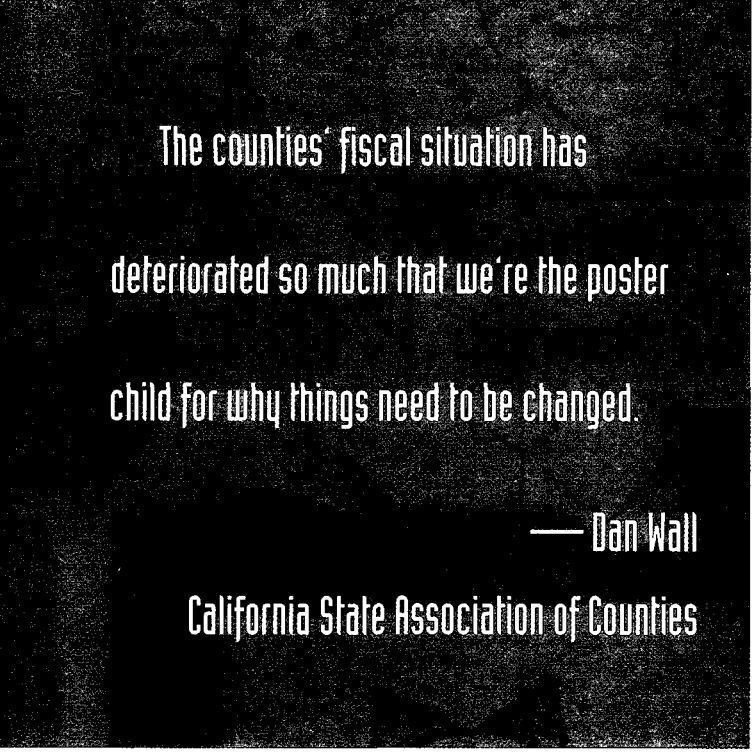
The counties' fiscal situation has
deteriorated so much that we're the poster
child for why things need to be changed.
— Dan Wall
California State Association of Counties

The fixing of the rate of course has continued to be felt over the years by local governments, along with another important — though unintended — change Proposition 13 made: The shifting of control over property tax revenues from local governments to the state. It is that transformation that has haunted locals ever since.

Following Proposition 13, other important changes, via the initiative process, have affected the fiscal operations of local governments. These include Proposition 4 [1979], creating a cap on government spending; Proposition 62 [1986], instituting a two-thirds vote by local officials and a majority vote of the local electorate for new taxes; and Proposition 218 [1996], which forced property-related fees and assessments to be put on local ballots. As a result of what has come to be known as "ballot-box budgeting" over the past 20 years, California has developed a system of finance for local governments that frustrated officials describe as piecemeal in design and disincentive in motivation.

"The incentives of the system don't make any sense," says Ron Bates, president of the California League of Cities and mayor pro tempore of Los Alamitos.

Echoing the same complaints heard from other local officials at the city and county level, Bates and his legislative allies point out that cities and counties have little motivation currently to allow new development when property tax earnings are increasingly swallowed by the state. "If local governments allow development in their communities and property taxes increase as a result of that development, then local governments should be allowed to keep that increase to pay for services," says Assemblyman Fred Aguiar (R-Chino), former mayor of Chino.

"The state always talks the talk about having a balance of jobs and housing and eliminating sprawl," agrees Assemblyman Michael Sweeney (D-Hayward), another alumnus of local government. "But all the fiscal incentives are to pursue sales tax generators now, to get the new Wal-Mart or Home Depot or the new car dealership."

Indeed, local governments have grown increasingly dependent on sales tax earnings — it now constitutes the largest share of revenue cities receive — because of the shifting of property tax revenues from cities, counties and special districts by politicians in Sacramento. In 1992, with the state trying to resolve a multi-billion dollar deficit, lawmakers and Governor Pete Wilson created the Educational Revenue Augmentation Fund (ERAF), which took over $2 billion in property taxes away from local governments and used it to backfill the state education budget. Since then, the shift has not only continued — despite the end of the recession — but grown in size because of inflation and new development, leaving cities and counties without $3.4 billion in annual property tax revenue that they would be receiving had it not been for the creation of ERAF.

"The counties' fiscal situation has deteriorated so much that we're the poster child for why things need to be changed," says Dan Wall, deputy director for the California State Association of Counties (CSAC). The problem has become so acute, says Wall, that counties — which have absorbed 60 percent of the financial loss from ERAF — have had to provide services with the fiscal equivalent of "band-aids, bailing wire and bubble gum."

The task of counties in providing services is especially d aunting even when ERAF isn't factored in. As an administrative arm of the state, counties must operate not only their own programs but those mandated by Sacramento officials, programs that the state doesn't fully finance. Trial courts, for example, are an important element in the state's judicial system and the counties must operate them and provide 63 percent of their funding. In addition to courts, counties also are responsible for providing public and mental health, probation, and welfare programs for local constituents.

And then, there's Proposition 218. The sweeping initiative approved by voters in November 1996 clamps down on the creation of new special taxing districts and requires that nearly all of those in existence be subject to a confirmation vote taken among property owners. Around the state city and county managers and attorneys are struggling to figure out which new and existing property fees and assessments must go before voters.

At least one major city has landed in court because of its implementation of Proposition 218. In San Diego, the dispute involves the collection of business-improvement fees that the city council chose to renew without voter approval, insisting that the fees did not fall under the purview of Proposition 218. The Howard Jarvis Taxpayers Association, which wrote Proposition 218, disagreed and is suing the city to have the fees placed on the local ballot. The organization also is monitoring implementation of Proposition 218 by other cities, with the expectation that other legal battles are on the horizon.

"This is our first enforcement action out of about half a dozen to a dozen we're going to be filing," Jonathan Coupal, the association's legal affairs director, told the San Diego Union- Tribune.

While they are in substantial agreement about the burden of the ERAF shift, cities and counties find themselves divided over the way in which those property taxes that do flow their way are divvied up. Soon after the passage of Proposition 13, the Legislature adopted what's now commonly referred to as the AB 8 formula — an allocation system

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of property tax dollars based on tax revenues that were generated before 1978. It is a formula that has split cities and counties into "haves" and "have-nots," since it rewards local entities that had high property tax rates before Proposition 13 with more money and punishes so-called "no-low" tax cities by allocating them less.

Wall agrees that inequities do exist among locals, but he also believes that "to pick on the formula is to miss the point." What's important to remember, Wall explains, is that all local entities are at disadvantage because of the structure of the finance system. Consequently, Wall believes there has to be serious and comprehensive reform of the way local governments receive their funding.

But whether change happens in pieces or systematically, local governments face a long and tough battle with the same political forces that helped create the problem in the first place.

Take ERAF for instance. Last year Aguiar carried legislation that would have capped the growth of ERAF so locals wouldn't lose any more property tax revenue. And although the bill cleared the Legislature without any opposition, Wilson rejected it, saying in his veto message that "it is inappropriate to approve a piecemeal approach to local government financing reform."

But a comprehensive approach — for which Wilson called last year — never materialized during this year's budget. Instead, the administration adopted its own piecemeal approach, allocating money for hospital administration, public safety funding, and had proposed to send $100 million in ERAF money back to counties. Even that $100 million wound up becoming a casualty of the budget endgame, when Wilson opted to pay off a $1.36 court judgement in one lump sum (see "Budget Blues," page ??)

The ERAF money Wilson proposed also did not impress people like Aguiar and Sweeney, who argue that the proposal doesn't even amount to a freeze in the growth. Sweeney complains bitterly about being "tag-teamed" by Wilson and Senate President pro Tempore Bill Lockyer (D-Hayward), who helped Wilson by blocking their efforts in the Legislature. "My sense is that [Lockyer] is not at all sympathetic to getting those [ERAF] dollars back to local government," says Sweeney.

The fact that state officials are reluctant to part with ERAF's billions comes as no surprise to League of California Cities lobbyist Dwight Stenbakken, who has lobbied without success to have the property tax money returned via budget negotiations. "It [ERAF] is like a heroin addiction — once you get it in the veins you don't want to give it up," says Stenbakken.

According to the Wilson administration, though, it is the counties who are hooked — hooked on money that they would never have gotten had it not been for the passage of Proposition 13. "We're taking local government money that we gave them," said state Finance Director Craig Brown. "The property-tax shift was undoing that to meet state priorities." Brown concedes the "fiscalization" of local decision making, which emphasizes shopping malls over housing developments, is a serious issue. But he says critics of the administration's approach to ERAF tend to leave out the steady increase in state subventions to local government

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since Proposition 13 passed in 1978.

"It depends on where you set the starting point for the debate," says Brown. "Locals want to start it at 1990. We would argue it starts in 1978."

With political channels in Sacramento appearing blocked, local government officials may end up going a different route to get help — a route, ironically enough, that has worked against them historically. For the past three years an impressive coalition of interests — including the Building Industry Association, California Chamber of Commerce, California Teachers Association, League of California Cities and CSAC — has been working to formulate a plan that would overhaul the finance system for local governments. Known as the California Governance Consensus Project, the effort hopes to restructure things so that locals will have greater flexibility and resources to meet the needs of their communities.

While no specific proposal is on the table, ideas being bandied about include redirection of more property tax revenues away schools, so that cities and counties can better meet other needs, while backfilling the education budget through others means, such as sales tax revenues. Such a plan would certainly relieve locals of their reliance on sales tax dollars — which Wall characterizes as a "less dependable revenue source." The problem for counties with sales tax revenue, as Wall describes it, is that it often runs counter to their needs, especially during recessionary times. "When the economy goes down, so does sales tax revenue, but that's when county services are most in need," Wall explains.

Those involved in the project say that they hope to have their proposal ready for next year's legislative session, and that if the Legislature fails to pass it, then they will put it on the ballot. But it remains to be seen whether such a plan can get pass the voters, especially if the project's most noticeable non-participant — the Howard Jarvis Taxpayers Association — opposes it.

Why isn't the anti-tax group involved in the project? Project director James Connor insists that the group was invited. Joel Fox, president of HJTA, disagrees. "I don't believe we were ever invited. At least we weren't invited on the first go around," says Fox, who saw the oversight as a snub of his organization's importance in the debate.

Despite this flub in political protocol, HTJA's sideline status does not mean that it is entirely opposed to helping local governments. In fact Fox is quite sympathetic with locals' concerns over ERAF, which HJTA has opposed all along. More important, Fox says that he's willing to discuss a re-examination of the Proposition 13 provision that allowed the state to take control of property tax revenues, which was a result of faulty drafting in the initiative.

"[Howard Jarvis] intended that the property tax would be dispersed by the counties," says Fox. The idea of weaning schools of property tax revenue and giving more of it to local governments is also something Fox stands behind. "When I served on the Constitutional Revision Commission I suggested that we ought to look at the state taking over more of the school funding and that more property tax stay with local governments."

All of this back-and-forth suggests that some room for consensus does exist between the representatives of Proposition 13 and those of local government. But ultimately only time will tell whether any serious reform — and fiscal relief — comes about the cities and counties of California.

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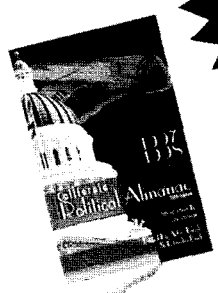

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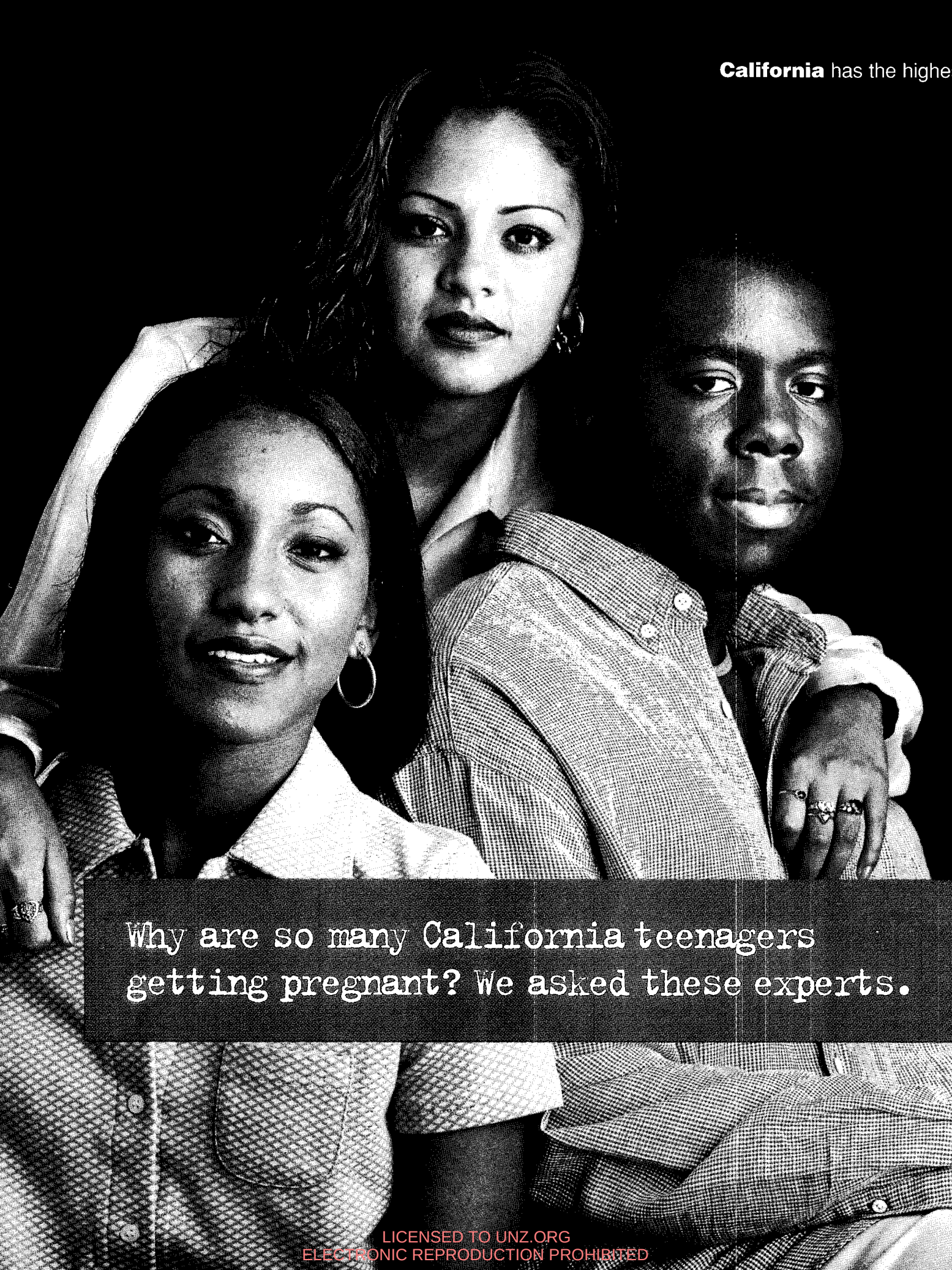

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een pregnancy rate in the industrialized world. This series asks **why**...and what we should do.

These California teens aren't experts because they've added to the pregnancy statistics. It's because they haven't. As peer educators, they teach other teens how to avoid pregnancy and sexually-transmitted disease.

"Kids are comfortable with us," says one. "We've just learned a little more and try to help them out."

We asked a group of peer educators to explain California's many teen pregnancies.

"If teens can't go to adults, they'll go to their friends -- who might tell them something wrong."

Misinformation is a major problem. "Parents know about sex and birth control, but hold back because they think their kids will go right out and try it," a young woman points out. "It'd be better for parents to tell us, and tell us the safe way."

That's also where sex education comes in, or should. But does it? "They hand you a book, but that's not like showing someone how a condom really works," says a teen who teaches sex ed. "And if classes are optional, too many parents say no. They should be required like English and math."

"Not just in 9th or 10th grade, either," adds another. "Start before kids are already into it."

"A lot is just focused on abstinence, abstinence, abstinence," comments a 17-year-old educator. "But what about teens already having sex? Take off the blindfold. Don't lie to us."

"Teens need a place where their voices can be heard..."

It also helps to have a future to protect. "They closed down the jobs program in this neighborhood," a young man says. "You go to apply for a job and they won't call you. You're just sitting there with nothing to do."

Viviana, Jejuana and **Greg** are 17-year-old high school juniors and peer sex educators in Culver City, California.

***Fact:** While the U.S. is aging, California is still getting younger.*

"I'm not pregnant because my mother gave me goals and there are other people who push me to do things I can't do if I have a baby," says one teen.

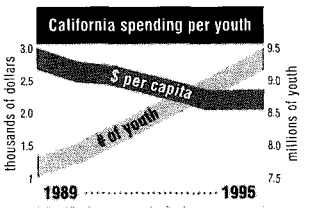
"We need a place to go after school and in the summer," her friend says.

"We need adults who get you into things to do and get you involved."

"If adults are meaning for teens to have babies, they're doing a great job."

What do these peer educators wish they could ask of adults? "Don't just judge teens, sincerely listen."

One young man adds, "Adults look at us like we're aliens or something. They don't take our relationships seriously. They see it like, 'You guys are children.' It cuts off communication immediately."



***FACT:** The state has 16% more teens than in 1989, but California's youth program spending has shrunk.*

"It's like you'll never talk to an adult again," another teen agrees. "You feel you'll be penalized.

"What we need from adults," she adds thoughtfully, "is for them to respect us—talk with us, not at us. And to listen."

This is one of many views of teen pregnancy in California. To consider the full range, send for our **free** reprint series by completing this coupon.

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Public Media Center Chart: Children's Advocacy Institute

Teen pregnancy is an adult problem.

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The Bottom Line

commentary

by Susan Rasky

Zero tolerance

Unnoticed amid the larger budget battles and machinations that preoccupied the Capitol this summer, a beastly little budget bill has been zipping through the Legislature and is now poised to make its way to the June initiative ballot.

The bill, carried by Senator Jack O'Connell (D-Santa Barbara) and sponsored by State Controller Kathleen Connell, is a proposed constitutional amendment (SCA 13) that would require the governor to develop his annual fiscal plan based on an outdated and discredited concept known as zero-based budgeting (ZBB). In addition, a companion bill (SB 1304) would set performance standards for each agency (how and by whom is vague) so that its efficiency and effectiveness can be evaluated. The Legislature, in turn, would be required to use this same methodology in making appropriations.

"The author and the sponsor indicate that ZBB, will, for the first time ever, force state government to justify every tax dollar it spends," according to the cheery summary that has accompanied the bill through three Senate committees and Senate floor passage by a vote of 29-5.

Originated in the late 1960s at Texas Instruments and championed by President Jimmy Carter, zero-based budgeting is not only passe as a private sector management fad but about as helpful in making public sector budget choices as, say, a directive to eliminate waste, fraud and abuse.

"Americans are in love with the notion that somewhere, somehow there is a process out there to avoid tough choices," says Professor John Ellwood of UC Berkeley's Goldman School of Public Policy. "The fundamental issue in budgeting is if you have to cut dollars, on what basis do you decide. Zero-based budgeting is silent on this."

Budget flummery is old hat in California. So are indifferent lawmakers, constitutional clutter and ambitious state officials looking to boost their gubernatorial prospects with sloganeering initiatives that cannot deliver what they promise But rarely does a single, seemingly innocuous piece of legislation offer such a concise illustration of everything that is wrong with contemporary policymaking and politics in this state.

Never mind that zero-based budgeting experiments in the federal government and in California during the 1970s were judged failures by the Congressional Budget Office and the Legislative Analysts Office. And never mind that Governor Pete Wilson vetoed the statutory version of SCA 13 last year on the grounds that any agency so inclined was already prefectly free to use zero-based budgeting to review its programs.

Connell is a woman with a mission, undeterred by history, logic, or, as last month's PERS debacle suggests, much concern about knifing her fellow Democrats in the back. "I don't believe in fixed expenditures. I'm from the private sector," she says.

OK, but what's O'Connell's excuse? A veteran lawmaker and a member of the Senate Budget Committee, he certainly knows better. Maybe he thinks he's in for a tough race in 1998, having "scraped by" with a mere 59 percent of the vote last time around. Maybe he figured a bit of recycled budget hoakum would make him popular with the Chamber of Commerce and the California Manufacturers Association, who are supporting the constitutional amendment. And maybe he figured nobody else would notice.

Surely, even in an age of term limits, lawmakers like O'Connell understand that zero-based budgeting will divert staff in an endless paper chase, preparing one set of books to satisfy Connell's fantasies about private sector efficiency and another from which the real budget decisions will get made.

Maybe they figured that kind of low-level fraud was harmless. But surely, even if an age of term limits, reasonably conscientious lawmakers should be expected to oppose writing the fiscal equivalent of motherhood and apple pie into the state constitution. Not because it's going to cause the collapse of the economy, but because it's just plain silly.

Then again, maybe not.

This is, after all, the same Legislature that found compelling need a few months ago to pass a law protecting a woman's right to breast feed her child in public. Had Wilson stuck to his principles and vetoed that measure as unnecessary, Californians no doubt would be looking at a mother's milk initiative next June.

Leading the charge against statutory protection for nursing moms is perhaps too much to have asked of any politician. But once upon a time, legislative leadership was understood to include the very important function of finding graceful ways to kill foolish bills before they got as far as the threshold of the ballot.

It is not too late. At this writing the ZBB amendment and the statutory version of its *au curant* descendant, performance-based budgeting, are scheduled for Assembly committee action in late August and presumably the Assembly floor before the end of the session. Performance-based budgeting experiments are already under way in several state agencies. The Assembly Democratic leadership might suggest that results of these pilot programs be evaluated before the state switches direction. That would allow Senator O'Connell, a popular fellow in the Capitol, to save some face with his constituents.

Of course such a compromise would leave Controller Connell in a bit of an awkward spot. Given the events of the past month, even the most timid of term-limited Democrats ought to find that prospect irresistible.

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Perspectives on

As the landmark tax-cuttin 20th anniversary, the debat

Flawed reform

by Jean Ross

Prior to the passage of Proposition 13, Californians enjoyed public services that were the envy of the nation. Two decades later, teachers in Los Angeles check books out at the beginning of class and collect them at the close, requiring students to use classroom time for reading that once would have been assigned as homework. Student-to-teacher ratios are the highest in the country, and only one state in the nation spends less on public highways. More fundamentally, the fiscal and programmatic relationship between the state and local governments has grown increasingly complex, thwarting the public's understanding of and ability to participate in civic decision-making.

Many of Proposition 13's most negative impacts on California point to potential solutions. First and foremost is the measure's widely acknowledged anti-growth bias. Several facets of Proposition 13 act in concert to discourage growth, particularly development of affordable housing and non-retail commercial activities. Proposition 13's cap on property tax rates and reassessment provisions prevent new housing and manufacturing from producing sufficient revenues to cover the cost of providing public services. Faced with this shortfall, local officials favor retail development for its sales tax generating potential over high-end residential development which yields higher property tax revenues per acre. Alternate revenue sources, such as developer fees and Mello-Roos assessments, shift the burden of paying for public facilities to new development, while costs for facilities serving pre-Proposition 13 properties are shared by the community at large.

A tax system that fosters growth would allow revenue levels to mirror the cost of delivering public services and spread the cost of public investment more equitably across communities. This could be accomplished by revising the inflation factor used to adjust property assessments and authorizing majority vote for bonds used to finance capital investments. The most egregious disparities occur with respect to commercial property. There is little economic or policy rationale for imposing a higher tax burden on new commercial development than is imposed on old. In fact, such a system is blatantly anti-competitive. A system whereby commercial property tax bills reflect the value of investment would eliminate local governments' preference for "big box" retail and auto malls over manufacturing.

Second, local government and, in particular, counties continue to bear the brunt of Proposition 13. In addition to the loss of dollars, local governments lost control over the allocation of property tax revenues and the ability to respond to local budget priorities. By transferring authority for allocating property tax dollars to the state and severely restricting elected officials' ability to raise revenues, Proposition 13 and more recently Proposition 218, sponsored by the descendants of Proposition 13, eviscerated local governments' ability to control their financial affairs. Counties now receive more than three quarters of their funds from state and federal funds. Restoring local control and certainty over local revenues would enhance local governments' ability to plan for the future. More important, it would establish a basis for sorting out the complex and often conflicting fiscal relationship between the state and local government.

While Proposition 13 succeeded at its primary goal — providing tax relief to lower income homeowners, particularly senior citizens — it did so at substantial cost. Commercial property owners reaped 40 percent of the savings, while over a third of the benefits from the property tax reduction went back to the state and federal government as higher income taxes. Only one out of every four dollars lost to local governments remained in the pockets of homeowners.

Despite claims to the contrary, California's taxes are moderate by virtually any standard. Yet due to lack of resources, the state is falling far behind with respect to education, infrastructure, and services that insure an attractive quality of life such as parks and recreation. Without reform, California will be ill-equipped to meet the challenges posed by a changing economy and an increasingly diverse and growing population.

Jean Ross is Executive Director of the California Budget Project, a policy research organization based in Sacramento.

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Proposition 13

nitiative approaches its over its impact continues.

Fairness for taxpayers

By Jonathan Coupal

Proposition 13 has always had its critics. It has been blamed for everything from fires and earthquakes to the murder of Polly Klaus. One would think, given the negative ink from the liberal media, voters would rush to repeal the tax cutting initiative. However, out in the real world, Californians know that Proposition 13 is working. Moreover, the voters (having heard cries of "Wolf!" too often) simply don't buy the hysterical criticisms. This is especially true with the complaints that Proposition 13 favors some property owners over others. This "inherent flaw" in Proposition 13 is actually a big reason why Proposition 13 remains so popular.

Because Proposition 13 uses acquisition value (usually the purchase price) as a basis of taxation, it is possible for owners of identical side-by-side properties to have significantly different tax bills. In short, the system generally favors those who have owned their property longer.

To understand why Proposition 13 is fair, one must understand how it works. Proposition 13 curbs property taxes by restricting the maximum rate (1 percent) and, more important, by limiting increases in assessed valuation (2 percent annually). With the latter provision, it is easy to see how a home's current value can greatly exceed its taxable value over a span of just a few years.

The substantial difference between a property's actual value and its taxable value disappears when the property changes hands. When this occurs, county assessors reassess the property at full market value. Thus, recent purchasers derive no immediate benefit from the limitation on annual increases in taxable value.

So is Proposition 13 fair, even to recent home buyers? Yes. It treats equally property owners who purchase property of similar value at the same time. Unlike any other tax system in the country, it provides absolute certainty to homeowners as to what their tax bills will be in all future years. It prevents a homeowner's taxes from skyrocketing as a result of the vagaries of the real estate market — something over which they have no control. Instead, the amount of property tax liability will depend almost exclusively on the voluntary act of purchase.

Critics might concede that Proposition 13 provides absolute tax certainty and yet still assert that the system is flawed because owners of similar property may be paying different tax amounts. The response to this is that it should be no concern whatsoever to a new resident what his neighbor's tax is — as long as his or her own tax is reasonable. The absolute cap of 1 percent imposed by Proposition 13 makes everyone's tax reasonable.

Critics also complain that owners of similar properties are paying different amounts for the same public services. However, this is no more unfair than the traditional method of taxation under which owners of more valuable property pay more for the same services. This entire argument ignores the nature of taxes. If we were that concerned with proportionality between the amount of tax and the level of service, we would resort to a system of nothing but user fees. Because proportionality between tax liability and services has never been an attribute of property taxes, it is unfair to level this charge against Proposition 13 alone.

Proposition 13 is certainty fair to existing property owners because it bases tax liability on acquisition value, not on the mercurial real estate market. It is fair to local governments because it allows for periodic reassessment of property when it changes ownership (and under other circumstances as well.) Few people realize the total property tax revenues to local governments in California have increased at a rate exceeding inflation and virtually all other economic indicators.

Finally, Proposition 13 is fair to new property owners, because it gives them two things they otherwise would not have: the benefit of a reasonable maximum property tax of 1 percent and the absolute certainty as to what their tax bill will be in future years. In light of increasing property values, this is not a minor consideration.

On the charge of "unfairness," Proposition 13 must be judged "not guilty."

Jonathan Coupal is director of legal affairs for the Howard Jarvis Taxpayers Association

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Conservative Republicans once held a virtual monopoly on political clout in Orange County. But changing demographics and some embarrassing controversies have put the "Orange County Mafia" on the defensive.

Losing its grip

by Jean O. Pasco

If the millennia of earthly history can be used as a guide, the dominion of Orange County Republicans over the landscape of state government was shorter than the dinosaurs, but it ended just about as abruptly.

The comparison is apt for the group of rock-ribbed conservatives and their progeny from the state's GOP stronghold who rose to power in the 1980s calling themselves "the Cavemen." Bent on an ideological transformation of Sacramento politics, they used safe seats to raise money from wealthy donors, assume positions of leadership and maneuver themselves to strike with a serendipitous boost from a willing electorate. The stars finally aligned in 1994. For a brief,

Jean O. Pasco is a freelance writer and an Orange County correspondent for the Los Angeles Times.

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Illustration by Steve Greenberg

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Democratic victories in 1996 hit like a meteor shower. But the retreat of Orange County Republicans and what happens next has less to do with partisan politics than it does with changing rules in the political game.

shining moment, it indeed seemed, as political analyst Sherry Bebitch Jeffe quipped at the time, that Garden Grove—home to new Assembly Speaker Curt Pringle, Senate Minority Leader Rob Hurtt and theretofore invincible Rep. Robert K. Dornan—was the center of the universe.

Democratic victories in 1996 hit like a meteor shower. But the retreat of Orange County Republicans and what happens next has less to do with partisan politics than it does with changing rules in the political game, changing demographics back home and a grudging realization repeated on the national level that governing is a lot more tricky than it looks.

"They had a rendezvous with reality," government professor John J. Pitney of Claremont McKenna College, a Republican, said of the GOP's fingertip grip on the Capitol. "The Republican edge was never something they could count on. With term limits, they also couldn't count on having Orange County people in positions of leadership very long."

Longtime Democratic leader Howard Adler of Laguna Hills said the fall was that much greater for the effort in getting there. "Republicans were on the outside [statewide] for so long and then Pringle and Hurtt really won it," Adler said. "It must have been devastating to them to lose it so quickly."

Prodded by the stinging defeat, Pringle announced earlier this year that he'd step down from his leadership post to prepare for a 1998 campaign for state controller. Dornan, ousted by the first Democrat elected to Congress from Orange County since 1982, is fighting his loss by charging Latino voter-registration fraud. Hurtt, leading a smaller GOP Senate contingent, could be challenged there by former Assemblyman Jim Brulte (R-Rancho Cucamonga), chief architect of the Assembly's brief GOP reign. Meanwhile, longtime conservative strategist Senator John Lewis of Orange, facing term limits in 2000, announced his intent to retire in two years and become a full-time political consultant. Former Assembly player Ross Johnson (R-Fullerton), Brulte's second-in-command, jumped to the state Senate in 1995.

Partisans on both sides agree that voter passage of term limits in 1992 was and is the single most transforming event in its effect on state and county partisan hierarchies. Proposition 140 set a six-year limit on Assembly terms and eight years in the Senate. Ironically, many Republicans supported it for one reason: to get rid of longtime Democratic Assembly Speaker Willie Brown of San Francisco.

More changes emerged from the electorate in 1996: Voters approved a strict campaign-finance law that severely crimps the barrels of money state GOP candidates used to raise from individuals, companies and groups, including millions from Orange County. Voters also passed an open-primary system that in 1998 will see all candidates appearing on the same ballot, lessening the chance of ideological domination by a slice of voters. Independents and the growing number of those eschewing party affiliations will vote for primary candidates for the first time.

Orange County voters tilted the playing field at home in 1996 with the election to Congress of Democrat Loretta Sanchez, a former Republican from Anaheim. Her campaign crafted a surprise coalition of Latinos, blue-collar voters and Republican women to squeak a 984-vote victory over Dornan. Sanchez's win energized particularly local Democratic donors, who broke tradition to pour money into her race instead of exporting their wealth elsewhere. It was an inspiration, particularly for a party that hasn't seen a statewide Democrat carry the county since Governor Jerry Brown in 1978.

"Loretta and her popularity created an anchor upon which we can do a lot of things [in 1998]," said Santa Ana attorney Wylie Aitken, head of the Democratic Foundation of Orange County and chair of Sanchez's campaign. "Once the emperor was seen with no clothes, it changed the game."

Even before Dornan's defeat toppled the electoral monolith built by the Orange County Republican Party, other events delivered gut punches. Though the villain of the county's disasterous 1994 bankruptcy was Treasurer Robert L. Citron, a Democrat, the county Board of Supervisors sitting when the county lost $1.6 billion was all Republican. And though two Republican supervisors ducked civil misconduct charges, the GOP continues to reel from ongoing felony election-law prosecutions of Assemblyman Scott Baugh of Huntington Beach and Rhonda Carmony, a longtime county GOP cam-

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Rohrabacher

Pringle

the November 1995 special election. That election recalled maverick GOP Assemblywoman Doris Allen of Cypress for becoming speaker with Democratic votes in 1995. It was Allen who blew the whistle on her former allies in 1995 when she accused them not only of "physical shortcomings" but of having used what she called "the Orange County machine" to rob her of a state Senate seat. She claimed party insiders conspired to dupe voters into believing that Ross Johnson, then an assemblyman from Fullerton, was the best conservative in a three-way race of Assembly incumbents, instead of staying neutral.

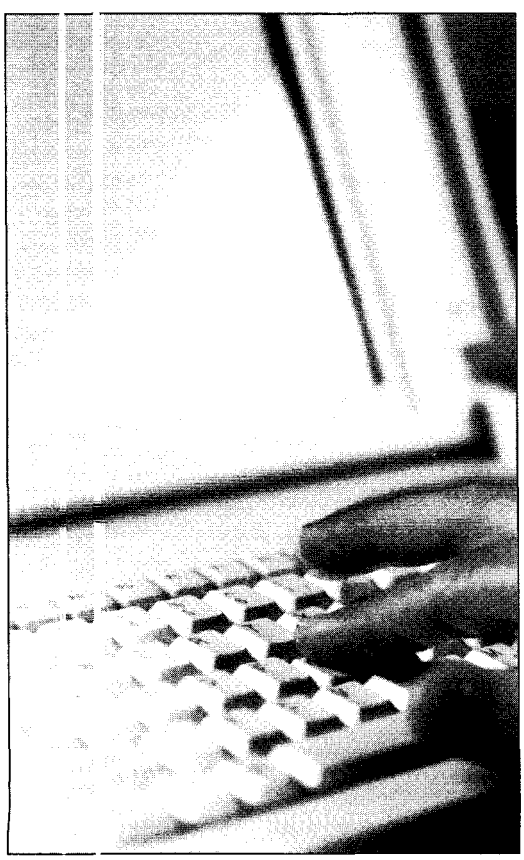
paign aide engaged to Representative Dana Rohrabacher of Huntington Beach. "Their invicibility image was shattered greatly," said Jeffe, a contributing editor to *California Journal*.

The Carmony case in particular carved a chasm in local GOP ranks between Rohrabacher and Pringle, whose chief of staff, Jeff Flint, was accused during the trial of having directed Carmony to break the law to help a spoiler Democrat qualify for

Control of partisan primaries won't be as easy under the new open-ballot system, which will force candidates in crowded races to appeal to as many voters as possible. Republicans in Orange County also will have to contend with a larger influence of more Democratic voters in the next century, a result of demographic trends acknowledged by both sides.

"The take-no-prisoners rhetoric, you're not going to be talking that way in a competitive county, and Orange County will become a competitive county," Pitney of Claremont McKenna College said. "It's going to be a long time before the Republican dominance is endangered, but Democrats will become more competitive."

That point is conceded by Michael Schroeder, the workaholic Santa Ana attorney who chairs the state Republican Party. He sees more Democrats registering in central Orange County,



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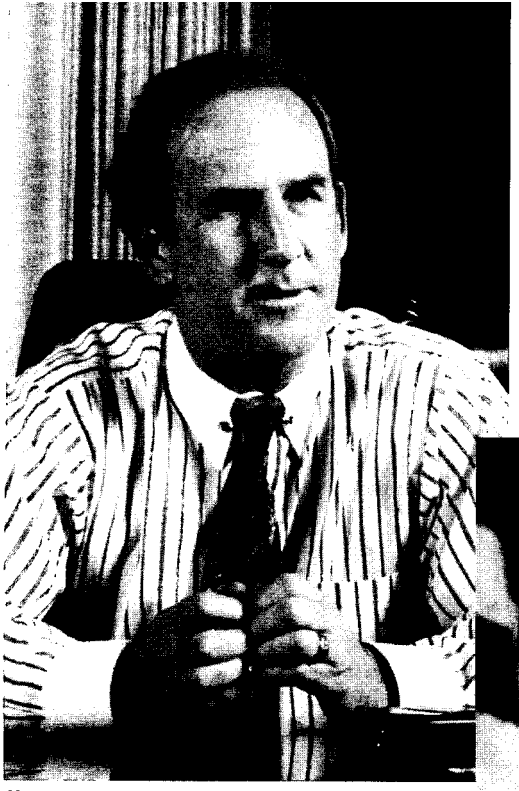

Hurtt

Dornan

particulary aided by Latino immigrants. But he insisted the area still is conservative, pointing out that both the central county's congressional and Assembly districts voted for 1994's Proposition 187, which banned most state aid to illegal immigrants. Schroeder also predicted the county's GOP power base will merely shift south with the growth of conservative Republicans moving into south Orange County's bedroom communities.

In the midst of all of the external changes, Orange County GOP candidates quietly began changing themselves over the past four years, observers on both sides said. The formerly rigid ideologues that had come to define hard core Orange County conservatives were being replaced by business conservatives more pragmatic in accomplishing their goals. The new leadership — characterized by Assemblywoman Marilyn Brewer of Irvine and Bill Campbell of Orange—also wasn't as interested in dabbling in other GOP races. It's an environment of bipartisanship mirrored at the national level, most recently in the balanced budget amendment heralded by both President Bill Clinton and House Speaker Newt Gingrich.

"In Orange County, the faces are different but the ideology is the same," Schroeder said. "The difference is you don't hear the new crop saying they won't work with Democrats. They've gotten smarter and more sophisticated."

What's happening, said political science professor Mark Petracca of the University of California, Irvine, is Republicans in California are beginning to believe like their national counterparts that bipartisanship is something the public wants. They're reading the same

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polling data, he said.

"Another thing is the fear by Republicans over the long term that they're going to be the minority if they don't start building those bridges now," said Petracca, a Democrat.

The only reason Orange County Republicans were able to take control of the Assembly was because they exerted control over their party and their party won more elections than it lost. They lost control because, once in power, they failed to convince the same electorate that they deserved another go at it. The hit list of those blamed for losing the majority, and why, is long — and starts with Pringle. As for Democrats, they were better able to convince statewide voters that the Republicans had gone too far. A similar national sentiment and a popular incumbent president helped.

"This is a fight for the middle, and frankly, we're better positioned to represent the middle," Aitken said. "The Republicans have a longer road to travel to get there."

Despite the turn of fortunes, The Orange County Republican Party will certainly retain its clout locally as long as it remains the majority party. And it'll keep its statewide clout also by the numbers both in registration and the region's continued willingness to fuel the party's money machine, despite the new requirements.

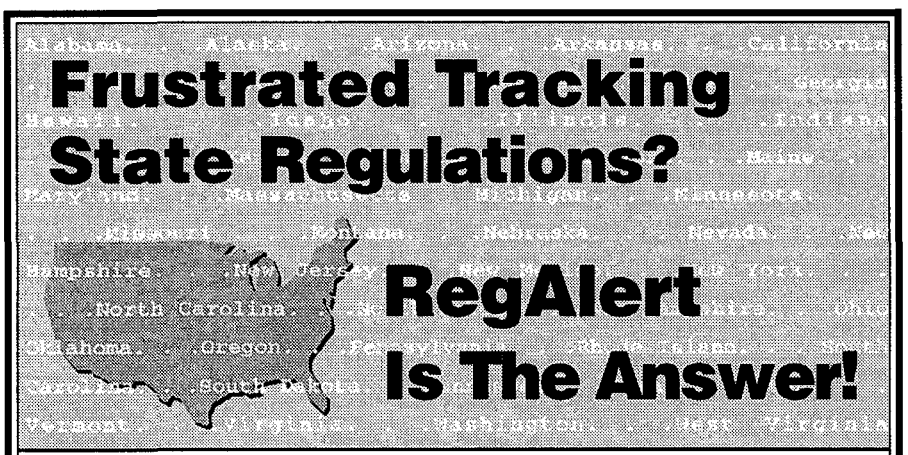
"In terms of Republican politics, they still have clout," Jeffe said. "Orange County's power is in what it takes to be nominated. As long as they have the registration numbers and their voters show up and vote, they'll continue to be influential."

Term limits, campaign-finance limits and open primaries should combine to eliminate most of the control the Republican Party exerts unless one final change occurs, Petracca said: The party may be forced to become more obvious in controlling who runs. That could come by reversing its longstanding policy of not endorsing in primaries, something allowed by the courts two years ago. Or it could be giving up the pretense that party leaders don't have a preference in primaries and making a public effort to get non-annointed candidates to drop out.

"Instead of just threatening candidates to get out of the race, they'll actually have to do something about it," Petracca said. "That's what makes it so interesting. They'll be in even less of a position to guarantee the outcome."

George Urch, former chief of staff to Democratic Assemblyman Tom Umberg of Garden Grove, is heartened by the county trends. But even as Republicans find themselves less able to count on unquestioned leadership, he doubts whether Democrats are poised to take much advantage. "Democrats have done almost no registration in Orange County in the last two cycles and they haven't done much infrastructure work," said Urch, who now works for the city of Ontario. "They don't have any machine to get these people cranked up and get them partisan. I see Democrats in the next decade picking up seats but, with open primaries, it's going to be moderate Republicans who flex their muscles. Moderate Republicans is the wave of the future for the county." Even so, that's good news for Urch, who was getting tired of the conservative monopoly.

"As a Garden Grove resident, I couldn't be happier," he said.



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Rostrum letters

Tribal Gaming

Why are Pete Wilson and Dan Lungren trying to squelch Indian gaming? The explanations offered in your article (see "Betting on Politics," *CJ*, August, 1997) for the fuss about Indian gaming just don't satisfy. It's possible the California Constitution is being vigorously defended by the man who would be governor and/or that Lungren and Wilson have a vendetta against the Indians for some bad political bets in recent elections. But neither explanation is persuasive, even in combination.

The estimated intake of $2 billion from Indian gambling casinos is only a part of California's gambling obsession. Indeed, gambling has become an integral part of California's popular culture — regrettably so — and a reliable revenue stream for state and local government. As you reported back in 1995 (see "High Stakes Game," *CJ*, April, 1995), "as much as $7 billion was wagered in California's 256 card clubs", another "$3 billion [was] bet on horses," and there was "more than $1.5 billion in sales by the state lottery" in 1994. Gambling revenues were projected to be significantly higher in subsequent years. All of this, plus the billions Californians spend every year gambling the night away in Nevada.

So why pick on Indian gaming? Because Indian gaming directly competes with the gaming officially sanctioned by state and local government and threatens a much anticipated revenue stream. Lungren and Wilson may be fighting Indians as much to preserve the state's monopoly on gaming revenue as to defend the Constitution or settle political scores.

Republicans trumpet the virtue of competition during campaigns. They just don't practice it very much once ensconced in office.

MARK P. PETRACCA, Ph.D.
Professor of Political Science
University of California, Irvine

Campaign accounting

Your article "To Run or Not to Run" (see *CJ*, June, 1997) incorrectly stated that "[Phil] Angelides lost to [Matt] Fong [in the 1994 treasurer's race] despite outspending him 2-to-1." In fact, the candidates spent an equal amount in the general election — approximately $3 million each. The disparity is due to the fact that you included Phil Angelides' costly primary election, whereas Fong did not have a contested primary race.

SUSAN BALTAKE
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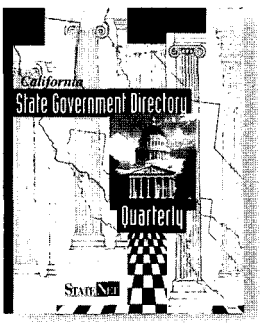

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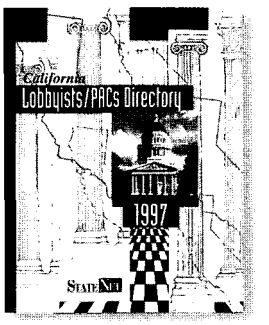

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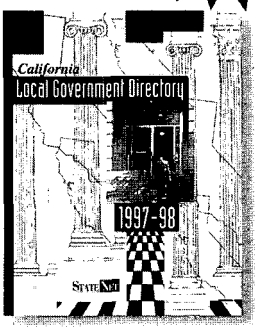

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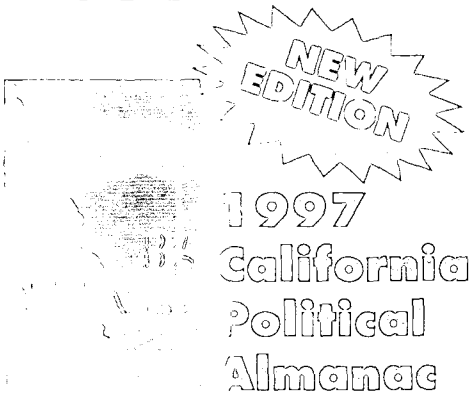

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Southern Exposure
perspective

by Sherry Bebitch Jeffe

Falling star

A decade ago, then-Assemblywoman Gloria Molina was featured on the cover of the *California Journal,* as an emerging Latino leader emblematic of that group's increasing political clout. In 1982, she had beaten the odds — and opposition from Latino power-brokers — to become the first Latina elected to the California State Legislature. In 1987, she beat them again to become the first Latina elected to the Los Angeles City Council.

Then four years later, thanks to a court-ordered reapportionment of the Los Angeles County Board of Supervisors, Molina moved up to become the first Latina elected to that powerful governing body — once described as "the Five Little Kings."

The new supervisor's political stock climbed. In Los Angeles, the 'Molina-for-Mayor" buzz started almost immediately. But she sat out the bruising 1993 free-for-all prompted by Mayor Tom Bradley's retirement. Leaving the board, she told reporter Hector Tobar, "would have been a betrayal of the Latino community's long struggle to win representation in county government."

This year, Molina joined the crowd of politicians who opted not to challenge incumbent Mayor Richard Riordan. Political junkies are beginning to handicap the 2001 race — when Riordan must leave office because of term limits, but the Molina buzz has quieted down. Why has the trajectory of this once-red-hot political star appeared to have slowed?

No one can say that Molina is politically powerless. In addition to her clout as supervisor, Molina holds sway on the Metropolitan Transportation Authority (MTA) Board; she remains a major player in L.A.'s fractious Latino politics, frequently warring against L.A. City Councilman Richard Alatorre, State Senator Richard Polanco (D-Los Angeles) and their allies.

Molina's official biography touts her "reputation for candor and independence." These characteristics have served her well among her constituents — for example when she led the fight against siting a state prison in her East Los Angeles Assembly district. But her "independence" has often isolated her from other constituencies and from political leaders in the Latino community and beyond the city's Eastside.

In 1986, Molina bucked then-Assembly Speaker Willie Brown (D-San Francisco), Alatorre, and most of the local Latino leadership, by supporting Mike Hernandez against Richard Polanco in the special election to replace Alatorre in the Assembly. This year Molina backed a challenger to Hernandez, now a L.A. city councilman, in the municipal election. The alternative newspaper *LA Weekly* derided Molina's "impulsive support," labeling her a politician "who often makes enemies of her friends."

During Molina's tenure on the City Council, her "maverick" politics — one member described her as a "bomb-thrower" — often made it difficult for her to get things done. Molina's relationships with her supervisorial colleagues have been no less stormy — at least in public. Behind the scenes, she's been known to compromise; back-channel negotiations with conservative Supervisor Mike Antonovich helped restore funding for health care, law enforcement and other areas during L.A. County's 1992 budget crisis.

In 1994 Molina endorsed Westside Assemblyman Burt Margolin (D-Los Angeles) in the Democratic primary for insurance commissioner — against then-State Senator Art Torres, a Polanco-Alatorre ally who'd lost to Molina in the bitter 1991 supervisorial race. But that bridge to the politically powerful Westside appears to have collapsed. Struggles over social programs and transportation funding have increasingly pitted the priorities of Westside and Valley voters against the needs of Molina's Eastside constituents.

Women's groups heavily backed Molina's political ascent. But their enthusiasm has ebbed, particularly since Molina endorsed then-Insurance Commissioner John Garamendi against then-State Treasurer Kathleen Brown in the 1994 Democratic primary for governor.

With Los Angeles moving surely toward a Latino majority, the fight for political dominance between the Alatorre and Molina camps has escalated and spilled over to the powerful Metropolitan Transportation Authority, on whose Board of Directors both sit. In July, *The Wall Street Journal* reported allegations made by a former MTA official that Molina "intimidated" and "harassed" him to prevent the award of a $65 million subway contract to a consortium which included two firms with ties to Alatorre. Alatorre, meanwhile, is facing questions about monthly retainers paid by these two firms to an event-planning firm founded by his wife. (Both supervisors have denied wrong-doing.)

Molina represents the wave of Latino political leadership which emerged from the Chicano Power movement of the 1960s and '70s. In the 1980s, the politics of faction offered Molina access to the corridors of power. As an "angry populist," she continues to provide a strong voice for the causes and concerns of her impoverished and minority constituents. Her rage and rhetoric have given her influence. But the boundaries of that clout largely coincide — both geographically and politically — with those of her bastions with L.A.'s Latino community.

In the 1990s, the politics of faction won't play citywide — despite a shift in the city's demographics which continues to increase the numbers and political clout of Latinos. Riordan's victories indicate that politicians must reach beyond their political base to build alliances with other leaders and among several constituencies. Coalition-building is key to the future of Los Angeles politics — and of city governance. It is in maintaining coalitions that Molina has failed. The question remains whether she can, will, or wants to turn that reality around.

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A rocky

The newly-minted California Earthquake Authority has made it possible to get homeowner's insurance again. But critics say the program is a bad deal for consumers, and could come back to haunt the state when the next "big one" strikes.

by Peter Blumberg

By one measure, the new California Earthquake Authority is an outstanding success. Last July, the state Department of Insurance logged 2,800 complaints from people who said they couldn't find any company willing to write them a homeowner's policy. In February, two months after the privately-funded, publicly-managed CEA opened for business, the department says it fielded only 70 complaints — a 40-fold decrease. "For the first time in three years, people really have no trouble finding homeowner's insurance," says Greg Butler, chief executive officer of the CEA.

But consumer watchdog Bill Ahern worries about a different type of complaint. "I get about 10 calls a day from people who don't know whether to buy this or not," says Ahern, a senior advocate with Consumer's Union in San Francisco. Often, he advises his callers not to buy CEA policies because the high premiums are not worth the coverage, particularly for homes that are unlikely to collapse.

Peter Blumberg is a freelance writer who lives in Sonoma County.

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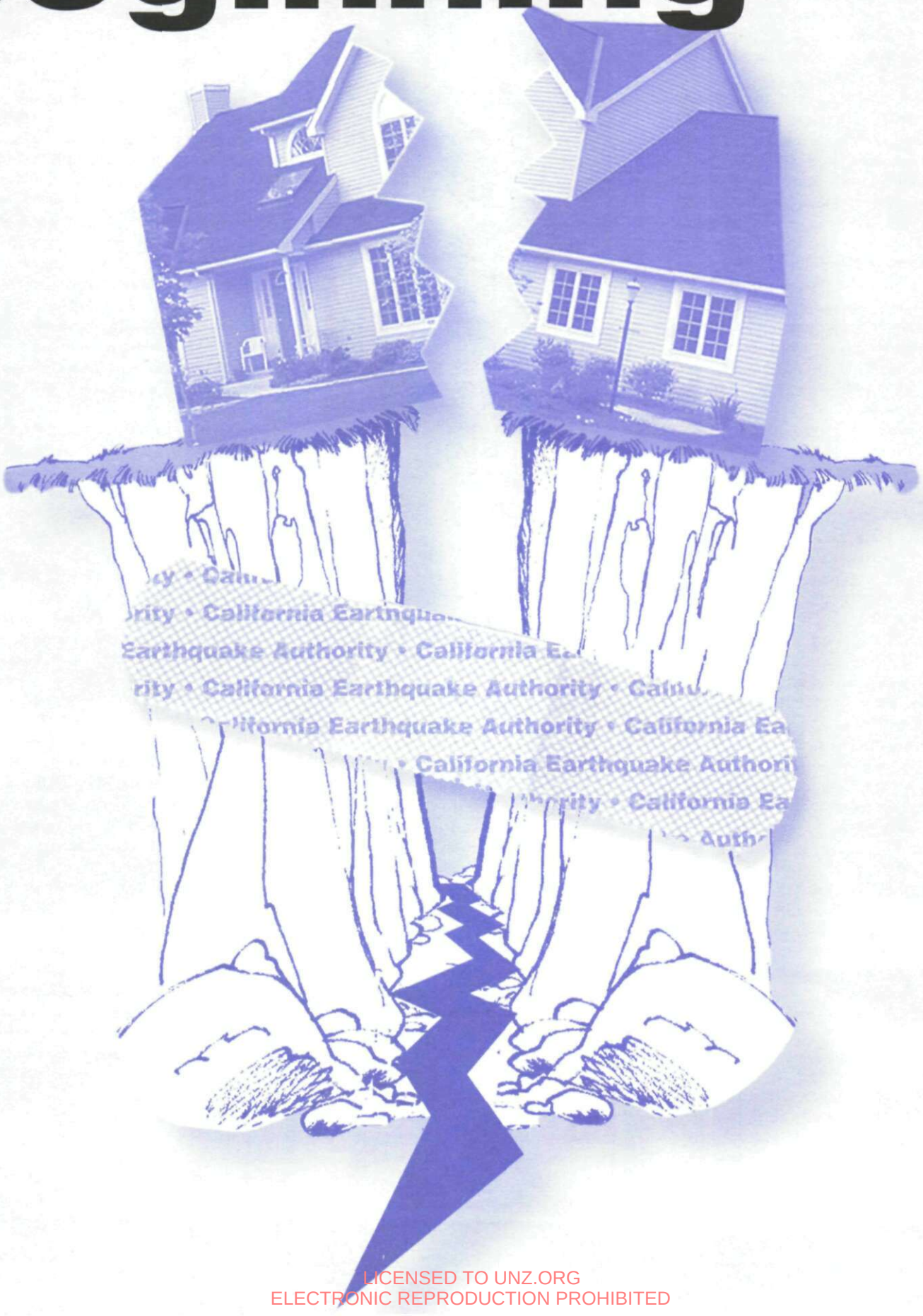
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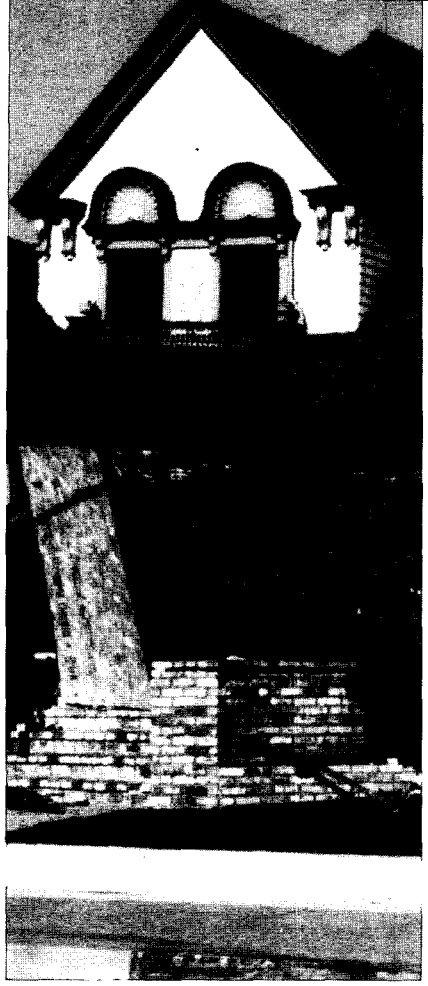
The mixed message from Butler and Ahern: Earthquake insurance is once again available, but that doesn't mean it's affordable. The CEA, the nation's first state-run earthquake insurance program, was developed after the devastating 1994 Northridge quake when most insurance companies either stopped writing or restricted homeowner's policies to reduce their exposure to earthquake losses. Now, in theory, no one should have a problem finding insurance, with CEA policies available from State Farm, Farmers, Allstate and nine other companies.

But CEA policies are so expensive and coverage for losses is so limited that many consumers are opting to go without quake insurance. If CEA had been in place during Northridge, thousands of homeowners, with average claims of $20,000, would have received little or no compensation. For starters, the CEA policies carry a 15 percent deductible, as compared with 5 to 10 percent deductibles available prior to Northridge.

The CEA's one-size-fits-all plan caps payments for personal property damage at $5,000 and allows only $3,000 for living expenses. Swimming pools, fences, unattached garages, driveways and landscaping are all excluded. Prior to Northridge, earthquake premiums averaged $2 per thousand dollars of insured property. Now, the average CEA premium across the state is $3.29 per thousand, with homeowners in some quake-sensitive areas paying three to four times what they used to pay. Adding to consumer frustration, has taken CEA more than six months to create an installment payment plan. At first, the only way to obtain the insurance was to pay the entire year's bill upfront.

Even more controversial than the coverage limits are the premiums that vary widely from one geographic region to the next. CEA has come under fire from insurance agents, consumer groups and seismologists — as well as the Department of Insurance and even Farmers — for adopting a confusing rate system based on zip codes. The critics allege the rate structure is discriminatory because it forces homeowners in areas of the state generally regarded as safe to pay unfairly high premiums to hold down the cost of premiums for homeowners in earthquake country. The complaints triggered a formal rate hearing that began



in May and may not conclude until the end of the year. By late July, however, there were signs of a retreat: CEA officials conceded that their model overstated risks in the Bay area, prompting the agency to lower premiums 11 percent on average across the state and offer refunds to customers who overpaid.

In CEA's defense, supporters contend the program has halted a mass exodus of insurers from the state — and thereby averted a crisis in the real estate market. And it has done so, they say, without pretending to offer more than barebones coverage to protect against catastrophic losses. From the beginning, the agency has maintained that it set the lowest rates possible based on the best scientific risk forecasting available. CEA officials say it's unfair to compare their coverage limits and rates with pre-Northridge earthquake plans because Northridge changed the market forever. "People keep comparing it to the traditional policies, but the fact is, there is no traditional policy anymore," says Milo Pearson, CEA's chief operating officer.

Despite lagging sales, CEA officials insist they aren't worried about the agency's financial stability. Butler estimates sales have been running about 10 percent lower than predicted, but he's confident the CEA will reach its target of 1.2 million customers within the agency's first 18 months. "We're a brand new product on the market asking for payment up front with no introduction to customers," Butler says. "For many customers this is a significant rate increase and we're getting further and further away from the last earthquake, [a time] when fewer people buy coverage. We've got many things going against us and our sales are performing well."

Then again, the CEA doesn't seem to know much about who is buying policies. The agency cannot say how many new homeowners have bought its earthquake coverage — versus those who've simply added the CEA plan to their existing homeowner's policies during renewals — because those numbers haven't been tracked. All the CEA can say for sure is that it issued 396,000 policies to homeowners, renters and condominium owners in its first seven months. That's one-third of the CEA's goal, but figures tallied by participating insurance companies do not support Butler's optimism about the other two-thirds. Farmer's, which had sold 91,452 CEA policies by July 1, reported that it has already offered renewals to most of its policyholders with pre-CEA quake policies and only 41 percent have agreed to renew their policies on the CEA's terms. Yet renewals are supposed to provide the bulk of the CEA's business, according to industry officials. "Because of the complaints I've heard out in the public about the price of the CEA, I don't imagine a lot of people are going to jump on it who didn't have earthquake coverage before," says Lonny Haskins, a spokesman for State Farm, the largest homeowner's insurer in California.

Of course, no one ever promised that the CEA would be popular with the public. The idea behind the CEA was to end the shortage of homeowner's coverage, which dried up after the Northridge quake caused $12.5 billion in insured losses and became the nation's costliest disaster. Because California law requires sellers of homeowner's insurance to also offer earthquake protection, most companies threatened to withdraw from the market altogether rather than risk taking another big hit

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from the next major quake. The authority helps spread the risk associated with quake losses by establishing a pool of $7.5 billion, financed largely by the participating insurance companies and premiums from quake authority policies, plus commitments from reinsurance companies and private investors. The insurers participating in the earthquake authority write a combined 71 percent of homeowner's insurance in California. Under the program, customers submit their claims to the company that handles their policy, but the CEA actually pays the claim and assumes much of the risk. Still, there is some risk for policyholders. If a giant quake exhausts the CEA's resources (which CEA officials insist is highly unlikely), claims would be paid on a pro-rata basis and policyholders could be assessed an additional 20 percent on top of their regular premiums.

The authority's opening last December was greeted not with press accounts of relieved homeowners but with a barrage of negative publicity over premiums. Provincial politics kicked in right away, with Northern California lawmakers assailing the new agency for discriminating in favor of Southern California, and lawmakers in the southern regions complaining that the CEA was forcing homeowners in some areas to subsidize others. Parts of the San Fernando Valley with no history of earthquakes were hit with higher premiums than areas where strong quakes have occurred. Meanwhile, in the city of Hollister, the self-proclaimed "Earthquake Capital of the World" for its proximity to three major faults including the infamous San Andreas, some residents were charged just $1 per thousand dollars of insured value, among the lowest in the state. Residents of the San Francisco Bay Area, where some of the highest rates applied, were charged 4.5 times more than Eureka residents, despite a history of damaging quakes in Eureka and the dangers of a tsunami.

The flap over rates stemmed from the CEA's attempt to apply cutting-edge methodology for evaluating earthquake risks. Before Northridge, insurance companies sorted homeowners into only two risk "boards": high and low, with high premiums assessed in places where quakes had occurred. After Northridge, though, insurers believed more precision was needed, so CEA hired a private structural engineering firm to do the risk assessment. Instead of the traditional claim data, the firm used computer modeling to estimate risk, using soil types, age of housing stock, construction materials and foundation types and came up with a zip code by zip code breakdown with more than 2,000 different rating zones. Eventually, 19 separate rating territories were identified, with rates ranging from $1.15 per thousand dollars of insured value to $5.25 per thousand. To make the numbers work out so that insurance would still be affordable in the highest risk areas, the quake authority capped rates in those areas, and raised them elsewhere.

CEA has hailed the model as "the most comprehensive database ever developed for earthquake modeling." But the engineering firm — EQE International of San Francisco — has been attacked by consumer groups for using "junk science" and not being forthright about the details of how the model works. More than two months into the rate hearings, watchdog groups were still complaining about EQE's refusal to reveal portions of the model for proprietary reasons. Insurance Commissioner Chuck Quackenbush heightened the suspicions of a cover-up in late July when he refused to allow a nationally recognized consultant whom he had hired to critique the CEA in the rate hearing to expand on his testimony.

Quackenbush, who makes a final decision on the rate hearing once the judge has issued an opinion, says reports that he'd muzzled consultant Robert Hunter were exaggerated by participants in the hearing who are "emotionally involved." But the complaints persist. "The CEA is not the National Security Council," said Philip Roberto of the Santa Monica-based Proposition 103

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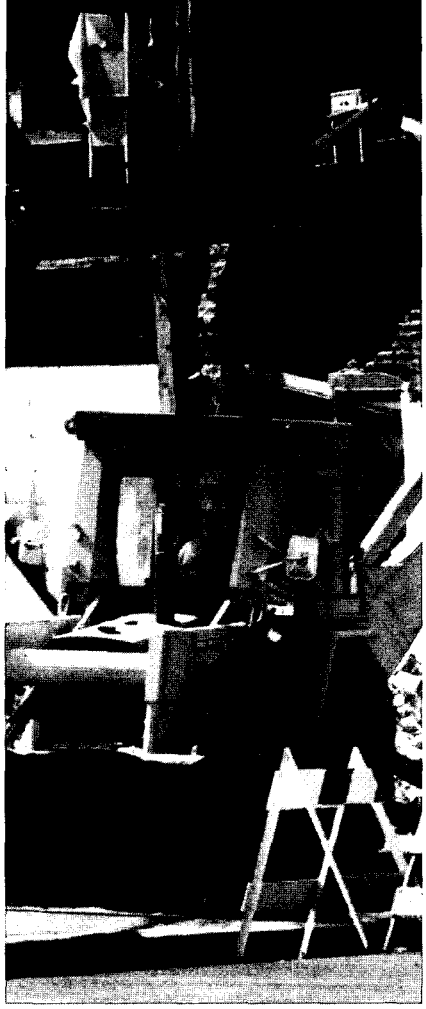
Enforcement Project, a consumer group that monitors insurance issues.

The debate over how to set rates is just one of many issues, big and small, that have occupied an army of lawyers, actuaries and scientists holed up since late May in a sixth-floor conference room at the San Francisco office of the Department of Insurance. Billions of dollars are at stake in arguments over whether the publicly managed CEA's finances are stable or shaky, and whether the participating insurance companies are being too greedy or barely breaking even. Among the items targeted are the CEA's practice of allowing insurers to charge a 10 percent commission "This is a unique take-it-or-leave-it policy with no marketing, no advertising, no selling, nothing to haggle about, no choices to make — and it takes 10 minutes of paperwork to fill out," Ahern says. "My policy will cost $1,000. The member company should not get $100 for filling out the application." CEA officials insist the commissions are reasonable and that no one's getting rich off their product.

As the CEA continues to find its footing, the ongoing challenge is to make sure that the people who most need quake insurance are getting it. CEA spokesman Mark Leonard notes proudly that CEA has issued a third of its policies to homeowners in seismically active Los Angeles County, an area which makes up about one third of the state's population. But these percentages, translated into actual sales numbers, are far less impressive: Of an estimated three million households in Los Angeles County, only about 130,000, or 4 percent, have bought CEA policies.



To be sure, the CEA is not to blame for the casual attitude that most Californians have toward disaster preparedness. But the CEA is not likely to change people's habits, either. Historically, only about 25 percent of California homeowners have taken out earthquake policies even though recent studies suggest that up to 75 percent of the states population lives in areas with the potential for earthquake damage within the next 50 years.

It doesn't help that CEA sales are expected to go down next year rather than up because Californians have a peculiar but human tendency to buy less insurance every year that goes by without a major quake. Worse still, the normal incentives that push businesses

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to maximize sales do not seem to apply to the CEA. As a provider of earthquake insurance, albeit one without stockholders, CEA's financial exposure — and the risk for its participating companies and investors — grows as its customer base grows. As long as the agency sells enough policies to pay its bills and invest in long-term capitalization, CEA is perversely well-served not to penetrate the market too deeply. Acknowledging this, Butler says: "I would only consider us in trouble if our drop-off [from sales projections] was 50 percent or more."

None of which inspires much confidence among CEA skeptics. Even before the Legislature pushed the state into the earthquake insurance business in the last two years, critics assailed the plan as a bailout for the industry rather then a benefit for homeowners. One of those critics was Harlan Goodson, who now sits on the CEA's governing board representing Senate President pro Tempore Bill Lockyer (D-Hayward). Goodson says lawmakers never should have caved in to insurance companies threatening to leave the homeowners market.

"I just don't have a lot of sympathy for those who go into the risk assumption business and then complain about living up to their end of the bargain," Goodson says. "We created an escape for the industry and created a market with no buyers ... I'm sick with it. I think it's one of the worst things we could have done."

Quackenbush, who spearheaded the CEA's creation, isn't fazed by the naysayers. Although he once described the CEA as a temporary stopgap, the insurance commissioner now envisions the agency becoming a model for other states in the absence of a national disaster insurance program. "This was the most carefully deliberated and exhaustively researched idea in my history in Sacramento," says Quackenbush, elected to the post in 1994 after eight years as an assemblyman. Quackenbush believes history will vindicate the Legislature's decision to implement the program, even with all its shortcomings.

"We went up every blind alley and dead end street and the only solution was the CEA concept," says Quackenbush. "If people feel their most important investment is their home, the CEA is an excellent program."

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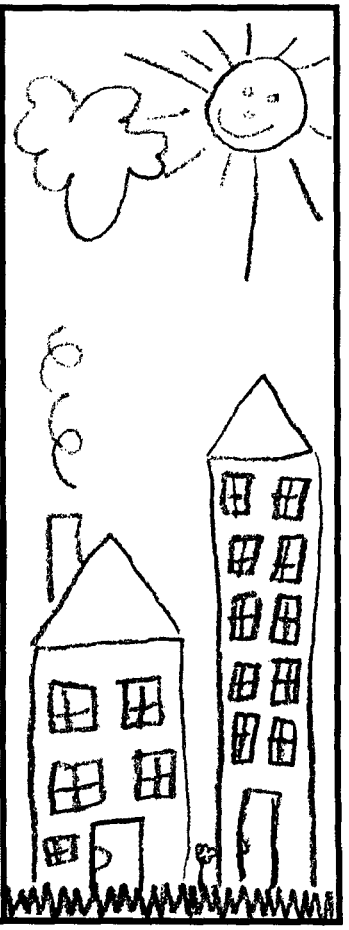

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Washington Notes

perspective

by Marc Sandalow

Gold rush

Even as Congress was balancing the budget, lowering taxes, and trying to keep the Pacific safe for dolphins this summer, Washington's political energy was focused on a marble-adorned hearing room across the street from the U.S. Capitol.

The Senate's campaign finance hearings attracted hundreds of reporters and many more visitors, only a handful of whom could keep up with mind-numbing details. The story line was so complicated that television abandoned the proceedings and even members of the media assigned to cover them often had little clue about what was newsworthy. Nevertheless, a picture began to emerge of the underside of American politics. During four weeks of testimony, witnesses provided a rare glimpse at a system so bent on raising money that it entrusted scores of young fund raisers with hundreds of millions of dollars in contributions and little incentive to be sure that everything was done above board.

Like so many movies, California often provided the backdrop for the tales of intrigue. It was at a Buddhist Temple in Hacienda Heights that Vice President Al Gore raised $140,000 for the Democratic Party. Among the $5,000 donors were Buddhist nuns who had taken a vow of poverty. There was Johnny Chung of Torrence, who allegedly arranged for a meeting between President Bill Clinton and Chinese business officials. There was Yogesh Gandhi of Walnut Creek, who only weeks before telling the IRS he had no U.S. holdings, donated $50,000 to the Democratic National Committee and was granted a meeting with Clinton.

There is still no answer to the central question regarding California — did the Chinese government target Golden State lawmakers in their quest to influence U.S. politics? It is known that the FBI warned several members of Congress that the Chinese government might try to make illicit contributions to their campaigns. Of the five members who have acknowledged they were briefed, four are from California: Senators Barbara Boxer and Dianne Feinstein, and Representatives Nancy Pelosi (D-San Francisco) and Tom Campbell (R-Campbell).

Republicans have suggested that the Chinese were interested in making illegal contributions to local and state campaigns as well, setting up a farm system that would pay off if today's local politicians became tomorrow's national figures. Republicans identified three California subsidiaries of the Lippo Group, a massive Indonesian bank with close ties to China, who allegedly funneled over $100,000 to Democrats despite never turning a profit.

The companies, all based in Los Angeles, contributed at least $20,500 to California candidates. Recipients included former state Treasurer Kathleen Brown ($7,000), former Lieutenant Governor Leo McCarthy ($4,500) and current Lieutenant Governor Gray Davis ($3,000). Probably the best California gossip came from the office of former California Senator David Roberti, whose administrative director Maeley Tom touted her friends for positions in the Clinton administration. Two letters written by Tom on California Senate stationery were distributed by committee Republicans to show how desperately Democrats wanted to please their donors.

In one letter, written to former Clinton deputy John Emerson (who since has returned to Los Angeles), Tom urges the administration to hire John Huang, calling him the "top priority for placement" by the Riady family, which owns the Lippo Group. Tom writes that Huang:" is the political power that advises the Riady family on issues and where to make contribution. They invested heavily in the Clinton campaign." Huang was appointed to a top post at the Commerce Department, before joining the DNC as a fund raiser. More than half of the $3.4 million he raised for the Democrats has been returned.

Tom also promoted several politically active California Asians, including Melinda Yee, currently San Francisco Mayor Willie Brown's director of trade. Yee, whom Tom described as a "savvy political insider," was appointed to the Commerce Department where she helped put together trade trips that have been criticized for their political leanings. The committee is expected to subpoena her this fall.

The hearings provided the best explanation yet of the fund raiser at the Hsi Lai Buddhist Temple. DNC fund raiser Richard Sullivan said the event, which was organized by Huang and featured Gore as its main attraction, was moved to the temple after plans to hold it at a private home or a restaurant collapsed. After Huang told him it was to be moved to a religious center, Sullivan said he told him it could no longer be a "formal fund-raiser." Sullivan said neither he nor Gore learned that money was raised at the event until he read about it in the newspaper.

California's peculiar real estate market provided a lighter moment in the hearings. Republicans called a bookkeeper from the Lippo Group to testify about the U.S. subsidiaries that had invested in American campaigns. To illustrate that one subsidiary was just a front, investigators got the bookkeeper to admit that despite setting up a Southern California office, the company's only holding was an abandoned parking lot in Los Angeles. It sounded suspicious until Democratic investigators asked the value of the parking lot. The bookkeeper responded that it was worth at least $1.5 million, with a development value many times higher.

By the time the hearings conclude late this fall, few prominent California politicos may go untouched. State Treasurer Matt Fong has already returned $100,000 in questionable money. And nearly every Democrat interested in the governor's race has been mentioned. Davis received money from the Lippo subsidiary. Feinstein hosted a fund raiser partially organized by Huang. And Al Checci — the Northwest Airlines executive looking to run for governor — attended one of the famed White House coffees.

Stay tuned.

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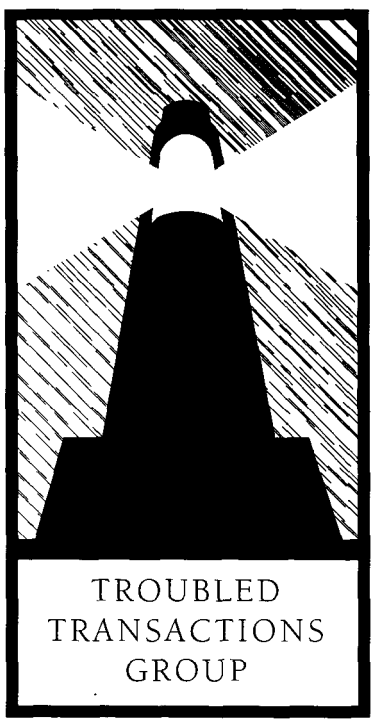

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